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RETIREE HEALTH BENEFITS: THE FAIR-WEATHER PROMISE

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

WASHINGTON, DC

AUGUST 7, 1986

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RETIREE HEALTH BENEFITS: THE FAIR-WEATHER PROMISE?

THURSDAY, AUGUST 7, 1986

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The committee met, pursuant to notice, at 9:36 a.m., in room SD-628, Dirksen Senate Office Building, Hon. John Heinz (chairman of the committee) presiding.

Present: Senators Heinz, Grassley, Glenn, Wilson, Dodd, Warner, and Chiles.

Staff present: Stephen R. McConnell, staff director; Robin Kropf, chief clerk; Larry Atkins, deputy staff director; Laura Erbs, professional staff member; Terri Kay Parker, general counsel; Isabelle Claxton, communications director; Sara White, deputy communications director; Diane Lifsey, minority staff director; Jane Jeter, professional staff member; Chris Jennings, professional staff member; Kimberly Kasberg, hearing clerk; Diane Linskey, staff assistant; and Dan Tuite, printing assistant.

OPENING STATEMENT BY SENATOR JOHN HEINZ, CHAIRMAN

Chairman HEINZ. Ladies and gentlemen, this hearing of the Special Committee on Aging will come to order.

As many people are aware, 3 weeks ago, the LTV Corp., America's second-largest steel producer, filed for bankruptcy. That Thursday morning, without warning, LTV also cut the lifeline to health insurance care for their 78,000 retired workers by terminating all health insurance coverage.

Earlier this week I went to Pittsburgh to meet with one of these workers. Henry Hennon happened to be in the hospital July 17. He had gone in confident that his LTV health insurance would cover the thousands of dollars in tests and evaluations he requires as a heart transplant patient. When Henry learned that his policy had been cancelled, he told me he felt like taking a dive right out the fifth-story window of his hospital room.

Bob DeMeo, the president of Local Union 1843 in Hazelwood, a very conscientious and hard-working man, told me he has received literally hundreds of calls from retirees in the same boat as Henry's. As Bob DeMeo knows, even retirees blessed with good health felt great anger at a promise revoked and the anxiety of a future without medical benefits.

The sad fact is, as serious, as alarming as the situation of these LTV retirees, they are not alone in their shock and outrage. There

were many in Congress who were aghast that a reputable employer felt legally justified in deserting its retirees in this way.

I do not think it is a coincidence that just 2 hours after I, as floor manager of the debt ceiling bill, called up the legislation introduced by Senator Metzenbaum of Ohio and myself to restore benefits, that LTV, just 2 hours after we passed that unanimously in the Senate, agreed to restore these health benefits pending review by the bankruptcy court.

There is a lesson, and a very important one, to be learned from LTV—it is a stern lesson indeed. LTV's actions illustrate the dangerous absence of Federal protections for some 7 million retired Americans who depend on employer health plans for coverage. Many are too young for Medicare, but they are old enough to be retired. Millions have been lured into early retirement by the promise of continued health benefits, and for many of these individuals private coverage would be prohibitively expensive. For many more with a preexisting condition, insurance is simply impossible to obtain.

Once retired, these workers find that the promise of health benefits for life is a promise a company can break with the click of the lock on the factory gate, or the bang of a door on the bankruptcy court. It is a promise the company can break even though the company itself will remain in business and earn a profit.

Abandoned retirees have sued their companies to make good on this promise, and so far courts in most cases have responded in their favor. But in doing so, the courts have also made it clear that Congress has provided no statutory protection for retiree health benefits. In fact, protection rests solely in the contract that retirees have with their employer. And employers clever enough to place limits on their contract promises will have no obligation to pay.

Now, the simple solution would be for the Congress to step in, as we did 12 years ago with pensions, and make these benefits permanent at retirement, but we also need to recognize the chilling effect this would have on the employer's willingness even to offer these benefits. Employers already hesitate to offer health coverage in retirement because the costs are open-ended and hard to control.

It is my view that Congress has to find a way to safeguard the health of our Nation's retirees and prevent these kinds of promises from being broken.

Our goal in this committee and in the Senate should be to make the pledge of retiree health benefits secure in fair weather and in foul. Our challenge is to combine this goal with reasonable, defined limits for employers.

At this point I would like to yield to an extremely valuable, conscientious member of this committee, someone who serves with me on the Finance Committee and, therefore, would be deeply involved in any legislation in that committee dealing with pensions, and who chairs another aging committee in the Senate, the Subcommittee on Aging of the Labor and Human Resources Committee, my friend and therefore my partner in many respects, Senator Chuck Grassley of Iowa.

STATEMENT BY SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. Well, thank you, and needless to say I enjoy working with you, and most importantly because of your willingness to take on some very difficult problems that face the older people of America, and you really leave no stone unturned. So I thank you in that same vein for this hearing you are holding on a problem that has been brought home immediately to people connected with one specific corporation in trouble, but actually it is a very general problem throughout our entire country, and more difficult now because of the constraints with which our economy is going through particularly in agriculture and in heavy industry. And we are going to see this problem brought very much home.

The testimony of our first panel will indicate that many retirees face very difficult situations when health benefits that they relied on ceased to exist. In fact, I think it is fair to say that those situations are often not just very difficult, but even disastrous for individuals and families.

Furthermore, the dimensions of this problem may be getting worse as health care costs increase and as companies try to reduce their exposure to large expenditures for health care.

It seems to me that one important aspect of this problem is the awareness employees have at a fairly early stage on the way to retirement of the confidence that they can realistically have in the availability of those retirement health benefits. At the very least, if people have reason to doubt that they can count on those benefits when they retire, they can have plans and alternative ways of providing for themselves.

Insofar as we need to move at the Federal level toward greater involvement in this area, it is important to keep in mind the need for balance between the needs of retirees on the one hand and the needs of present employees and the needs of firms which wish to continue health care benefit programs and in some cases, continue operation.

As one of our witnesses will stress, tradeoffs must be made. I think we should look for solutions in this area, but in doing so we should try to be as clear as we can about the tradeoffs that we will have to make, because there is "no such thing as a free lunch," and obviously, in this area that we are talking about there are some costs. But we do have a responsibility to the greatest extent possible to be fair to those who are retired, near retirement, as well as those far away from retirement.

Clearly, if there is a way to rectify situations like those described by our witnesses without jeopardizing the continuation of benefits for other employees or the continued ability of firms to remain viable, we should of course try to find those alternatives.

So in that vein, Mr. Chairman, I know that is why you are holding the hearing, and I hope that this hearing will lead us to legislative alternatives that we can act upon in the Committee on Finance.

Chairman HEINZ. Senator Grassley, thank you very much.

I just want to note that when we held a hearing on a related issue on July 29, 1985, which was a joint hearing between the Finance Committee and this committee in which Senator Grassley

participated, we were analyzing the issue of so-called voluntary employee benefit associations—an issue not unrelated to this—and at that time, we recognized there were serious problems in creating incentives for employers to create health insurance coverage for their employees. Equally serious, although less serious at that time than we recognized and we now recognize today, are problems with maintaining those promises, as I said, in fair weather and foul. Senator Grassley has been a participant throughout all these efforts we have been making.

It is a pleasure to introduce and recognize the ranking minority member on this committee, Senator Glenn, who spent a lot of time on the Floor last night, about 4 or 5 hours waiting to debate an amendment, which is about par for the course, I guess.

Senator GLENN. That is right.

Chairman HEINZ. He was not on the winning side, but that is all right with me, because I was on the other side. He is on the "right" side in this committee, I want to tell you.

Senator GLENN. And I was on the "right" side last night, too. [Laughter.]

Chairman HEINZ. "Right" does not necessarily make might.

Senator John Glenn.

STATEMENT BY SENATOR JOHN GLENN

Senator GLENN. Thank you, Mr. Chairman. As ranking member on this committee, I am pleased we are holding these hearings, "Retiree Health Benefits: The Fair-Weather Promise?"

We just faced a crisis in Ohio and across the country when LTV went into chapter 11 bankruptcy. A lot of people in Cleveland and Ohio, in fact 31,000 people, found themselves suddenly without health benefits. That shows what can happen to retirees. And there were some 80,000 as I understand it, nationally, involved with that whole situation.

Since July, after Senate passage of a bill that Senators Heinz, Metzenbaum, myself and others introduced—we were able to get LTV health benefits extended temporarily for 6 months while the bankruptcy courts sort out some of these assets and what they should be used for. And we hope the bankruptcy courts do continue that coverage because it is vital. When you have loss of health insurance at a time when you are beyond your normal working years—why, we know how devastating it can be.

Department of Labor estimates show that unfunded employer liability for retiree health coverage may have reached $125 billion in 1983. Now, that is a little old, but those are the most recent figures we could get. And estimates are that that figure may be jumping by about $5 billion annually.

Today, practically no employers are funding these benefits because there are no tax breaks for prefunding, and it would dramatically increase their annual costs.

So we now have a pay-as-you-go system of private health insurance coverage for our Nation's retired workers. And, if we look at employers' looming unfunded liability for these health benefits—it is reasonable to think that some companies are going to stop promising health coverage for retired workers.

Retiree health benefits represent an open-ended liability. What happens if a company goes under? I think the committee has to consider this, probably not this year, but maybe getting into next year. Do we have to go to some sort of a system where insurers—the employers, that is—paying for insurance, should fund that and fund it not out of future earnings where there may not be any if a company goes downhill, but where it has to be paid into some sort of a Federally guaranteed fund. And I hate to open up the possibility or the specter of another Government agency. But I also do not like the specter of 31,000 people in Ohio going without health benefits because a company has tough business times.

So I think we have to look into some of these possibilities. And I would say this. Even some of the unions have not agreed with us on this, because some of them have pension plans or retirement or health plans that they like to control themselves. So it is a difficult situation, and it will be a sticky one when we get into it, I am sure, but I hope that we get into that next year. We have our plate full this year.

We all know how much health care costs have been rising, and Members of Congress are confronted by the problem every year during deliberations on the budget. We have been passing deficit reduction legislation that shifts more Medicare costs to employer health plans. Yet then if the employer cannot pay, what happens? Well, the people do not have their funding.

Let me just add on this, too, I have gone through some of this in my own family recently, where a family member that I thought had full insurance coverage had no medical coverage whatsoever. She had a bad automobile accident, is in the hospital now, and was in the ICU for about 6 weeks. I will not go into the specific details, but the costs are staggering. And most families could not cope with it. Fortunately, I have enough money that we are going to be able to make it, but I will tell you, it is tough. And someone with less resources would not have made it, unless they get down to that $2,000 level where they are eligible for Medicaid. They may get good treatment, or may not, depending on what happens under the Medicaid situation. So I throw that in as a little personal example that has brought this home to me very, very forcefully in recent weeks.

Other people who have preexisting medical conditions—such as cancer—may find it impossible to get any coverage. If they are able to qualify, they may not be able to afford it. Individual insurance policies are expensive. They average 56 percent of income for couples aged 62 to 64 living only on Social Security benefits, and 35 percent of retirement income for those with pensions. That is horribly expensive for people beyond their working years. And some of them cannot even get the insurance.

For some retired Americans, loss of health benefits can be the greatest loss. While some payment of pension benefits is guaranteed by Federal statute, there is no similar protection for health benefits. And I think that is an important thing for people to realize.

I went back and checked my own health insurance situation the other day, and I was appalled at what I had not done through the years. In the name of heaven, check your own, I will just say to the

people in this room. I do not know how many of you have been through it recently, but go through it, because I was appalled at what lack of coverage I had myself.

So I will repeat that last sentence again, that I read: While some payment of pension benefits is guaranteed by Federal statute, there is no similar protection for health benefits. And even if their pension benefits are reduced when a company goes into bankruptcy, many retirees can find a way to cope. This is because there can be some certainty and control over basic expenses such as food, clothing and shelter—but they cannot plan to meet a hospital bill to treat the costs of cancer and diabetes or heart problems or things like that. It is a tragic situation.

Often, a company will offer a retirement package of pension, health and life insurance benefits that is simply "too good to turn down." This is an offer you cannot refuse when you are in negotiations. That sounds fine. If it is an expanding company, and their resources are good, and they are going on into the future—an expanding, viable, vibrant company—that is great; you get it. But what happens in shifting industrial patterns as we have in this country, when you go downhill? Through no one's fault, through the changing international trade patterns that we have had in steel and so on—companies have not had this all under their own control; they are not all stupid running these companies. They have had tremendous problems. So the benefits are lost, and you or your spouse comes down with a life-threatening disease, and you have no money to pay for your catastrophic medical costs—what will you do? That is one of the questions we are trying to look at today, obviously. I am sure it is going to be a series of things that we will look at, not just in this hearing, but on into the days and years ahead.

So Mr. Chairman, I applaud your initiative in holding this hearing. We need to get a clear fix on these issues and how we can come up with solutions.

I would particularly like to thank Mr. Len Harris for coming here from Dayton today to testify, and I look forward to reviewing the testimony of all the witnesses today.

Thank you.

Chairman HEINZ. Senator Glenn, thank you very much.

Before we hear from our first panel of witnesses, I am going to insert in the record, without objection, the statements of Senators Larry Pressler and Lawton Chiles.

[The statements of Senators Pressler and Chiles follow:]

PREPARED STATEMENT OF SENATOR LARRY PRESSLER

Mr. PRESSLER. This is an extremely important topic we are focusing on today. I commend Chairman Heinz for calling this hearing, and the Aging Committee staff for their report on the problem of terminating retiree health benefits.

To find oneself suddenly without health insurance, is certainly a frightening predicament for any retiree. That is what recently happened to 78,000 LTV steel retirees. Fortunately, LTV has since reinstated their retiree health coverage due to quick Senate action and public outcry. But, how long will it last? This is obviously a short term answer.

As the Committee Staff report states 84 percent of employees of large firms are promised continued health coverage—50 percent in smaller firms employing 100 to 250. Nearly 7 million retirees depend on employer-sponsored health insurance. The liability of providing these benefits is estimated to be $98 billion to employers.

Unlike pensions, which are guaranteed by the federal government, there is no such protection for health benefits.

What most people might not realize is that a large number of these retirees are not age 65 and thus, are ineligible for Medicare. Companies attempting to reduce their workforce offer enticing early retirement packages with a promise of continued health coverage. However, when these companies find themselves in serious financial difficulty, these benefits can be the first to go.

With the liability of health benefits being so costly, I do not feel the blame can be entirely placed on the employers. Our health care costs have risen dramatically. Only in very recent years, have we begun to reward and encourage efficient, less-costly medical care. We have a long way to go.

So, in closing Mr. Chairman, I believe it is imperative we examine this issue in detail. I am interested in exploring avenues to assist employees, retirees, and employers. I look forward to hearing the testimony from our witnesses today, and working with them in the future to preserve health benefits for all Americans.

PREPARED STATEMENT OF SENATOR LAWTON CHILES

Mr. CHAIRMAN. I think that it is good that we are holding this hearing today and taking a look at this problem.

This certainly is another piece of what sometimes seems like a "jigsaw puzzle" when we consider health programs for our retirees. And the picture that the staff has laid out in their report on this subject is, again, not a positive one.

Over the last few months, this committee has heard about problems in the nursing home area, problems in the promptness of payment of medicare benefits, problems with kidney dialysis, and problems with the quality of care medicare beneficiaries are receiving. The problems, as we can see from the hearing today, are in the private sector as well as the public. The retiree is getting squeezed by the ever upward spiral in health care costs, but so is the employer.

If we mandate coverage for retirees, then employers may opt to discontinue offering any plans of coverage, or we may see the same problems crop up in this area of insurance that we have in liability: coverage will be available, but no one can afford it.

Its a tough situation! But one that we need to consider in the context of the broad picture of overall coverage. I will be interested in the testimony of our witnesses.

Chairman HEINZ. Let me ask our witnesses—Mrs. Grimaldi, Mr. and Mrs. Taylor, and Mr. Harris, to please come forward and take your seats at the witness table.

Senator Glenn, would you like to introduce Mr. Harris?

Senator GLENN. Yes. Mr. Harris, we are very glad to have you with us here this morning, and glad to have you come in from Dayton and give us the benefit of the experiences that I know you have had. We have looked at some of your testimony and the staff, of course, has talked to you, and we look forward to hearing your testimony this morning.

Thank you for coming in.

Chairman HEINZ. And I want to welcome two constituents of mine, Sylvia and Gerald Taylor, from Aliquippa, PA.

Aliquippa, I will say to my colleagues, is a town that has been through more than its fair share of difficulties. It had a steel mill most of which continued to operate all through the recession, the old J & L Aliquippa Works. It has four blast furnaces, and three of them operated through the depths of the recession. Now, all of them are shut down. What was a depression in the 1930's in Aliquippa is well beyond the depths of depression right now. I want to express my gratitude to the Taylors for making a real sacrifice in coming here.

Senator GLENN. Could I add just one other statement, Mr. Chairman, on Mr. Harris, if I might?

Chairman HEINZ. Yes, certainly.

Senator GLENN. I did not give enough background on this. He came from Dayton where he worked for a company for 30 years. It closed its doors to operate a new plant in Indiana. He thought his pension, health and life insurance were protected, as I understand it—just exactly the situation I was talking about—until he and his wife were eligible for Medicare. He found out that was not the case, and as he told the staff, he sat in his living room and cried. He sat in his living room and cried, and I can understand that exactly. And that is what this whole hearing is all about—is trying to prevent more stories exactly like that, Mr. Harris, so we appreciate your coming in.

Chairman HEINZ. The person who is going to be our first witness is Lillian Grimaldi.

We welcome you and would like you to please proceed with your story.

STATEMENT OF LILLIAN GRIMALDI, NORWALK, CT

Mrs. GRIMALDI. First of all, Senator Heinz, thank you, and Senator Glenn, Senator Grassley, ladies and gentlemen, for allowing us to come to speak before you.

And may I point out, please, that the last public address I made, I was in the ninth grade. And I will be following Elizabeth Taylor's lead by reading my notes—and I should look so good.

Everything was fine for my husband and me until he suffered a heart attack in 1975. That was 5 years before he planned to retire. The cardiologist advised at that time that major surgery was possible down the road. Due to the nature of my husband's illness, he was forced to retire at the age of 60 on disability. At that time I was working. Life was simple, and we felt secure because we were fully covered with major medical insurance by Teledyne, and of course, the company for which I worked, with a guarantee that his coverage would continue throughout his retirement.

Our bubble burst—like all others—when in 1981, Teledyne dissolved its facility in Stamford and moved to Chicago and summarily dropped all life and medical insurance for retirees. We did not actually receive notice until 1 month after our benefits had been canceled. You cannot imagine the stress and the anxiety this caused, especially since I too had retired and canceled my policies with my former employer.

Had Teledyne offered us the option to pick up the cost of the insurance as a group, I am certain the other 132 families of retirees involved would gladly have participated in this plan. But such a plan was not offered.

During the course of the next 5 years, we were forced to purchase coverage with Blue Cross because Medicare was grossly inadequate. For example, Medicare approved $200 of an $800 anesthesiologist bill and then only paid 80 percent of that. Our out-of-pocket expenses above premiums to Blue Cross, which alone were about $900 a year, amounted to $14,000—this, until December 15, 1985. On December 18, my husband suffered cardiac arrest, requiring lengthy hospitalization and testing. The bills are still coming in.

I have undergone surgery four times during this period, and just recently developed a chronic eye ailment requiring frequent visits

to my ophthalmologist for treatment—19 to be exact in a 5-week period. Medicare disallowed 12 of these visits, consequently costing us an additional $360.

Our monthly income is $1,200, of which we need at least $400 a month for medical expenses—and this is minimal. After taxes, utilities, and other such "luxuries," it does not leave much; yet, we do not qualify for Medicaid, State aid or food stamps, because we have been able to maintain and own our own home.

Our fear is the loss of our property and the humiliation associated with this loss. In one instance, a retiree in our Teledyne group did lose her home because her medical costs were so exorbitant.

This is the reality of retirement without benefits—insecurity, stress, humiliation and frustration. Through the untiring efforts—and I have to state this—of the United Steel Workers of America Local 701 and their excellent attorney—I am going to give her a plug—Janet Bond Arterton and her associates, a court settlement has been reached for the retirees of the Teledyne Mount Vernon Die Casting Co. Our benefits have been reinstated, and we have been reimbursed for our out-of-pocket expenses through December 15, 1985. Our bills between that time and the date our coverage was reinstated, between the period of December 15 and August 1, are still outstanding. We are eternally grateful to these people for their combined efforts in securing this for us. Therefore, gentlemen, I am not here to speak for myself, but for all the others in similar circumstances who may not be as fortunate nor have a powerful group to fight for them. That is why I am here today, asking you to fight for them.

One of the characteristics of senior citizens is the pride for our accomplishments, which we often lose. Please help us retain our dignity.

Thank you.

Chairman HEINZ. Mrs. Grimaldi, thank you very much.

What we are going to do is let each of the witnesses go through their comments and statements and then we will return to questions from all of us to each of you.

Our next witnesses are the Taylors. Mrs. Taylor, Thank you very much. Please go ahead.

STATEMENT OF GERALD AND SYLVIA TAYLOR, ALIQUIPPA, PA

Mrs. TAYLOR. As you know, there is a crisis facing senior citizens in this country. In some cases, it seems you work for an employer for years only to find that the employer has no regard for his employees. If you do not have any money set aside for your later years, you may not get your retirement benefits because your employer felt he had the right to use the money he promised you upon retirement for his or her own gain.

In our case, my husband worked for LTV for 17 years. In February 1985, he was diagnosed with lymphoma myloma. This is a form of cancer, and he was forced take take a disability retirement the following September. He has undergone 10 months of chemotherapy.

I have with me a list of medications and medical coverage which we have or had, as the case may be at this point. In time, there is

some doubt about it. The company has canceled their coverage to all their employees in a letter received from them July 17, 1986. Now they say there is coverage until January 1987. Who knows?

At this point, I do not know what to believe. But do you think we could afford to pay these bills that until now have been paid by the company and the medical insurance coverage? Hardly. They amount to $29,147.40.

Now, if this is not enough, I have a heart problem that is being maintained on medication at a cost of $56.27 a month for my problem alone. I have with me the medical bills that are not covered or have not been turned in to the major medical portion of the insurance policy for payment. We are not eligible for Medicare, though my husband will be in September 1987.

Now, tell me if you can where we are going to get medical or life insurance coverage at this time. As you know, most companies will not cover preexisting conditions.

When my husband first got sick, we were lucky enough to have a bit of savings to fall back on. Now, the $2,500 we had saved is down to $300. The rest went to pay for medical expenses that were not covered by insurance, and just living.

We live in the suburbs of our town. We have a mortgage on our home yet. Are we to lose this because some company decides to fold or declare chapter 11? The mortgage payment is $180 per month. The house insurance is $170 a year. The electric company gets $130 or $140 a month. Then there is the cost of garbage collection, at $6 a month; the water, at $9 a month; telephone bill, at $13 a month minimum; last but not least, the oil bill for the winter months at a cost of who knows what, because of the up-and-down market in that field.

We did not get Social Security disability until September of 1985. Until that time, the only income we had was Gerald's $357 a month Social Security supplement insurance. I hate to even think about what would have happened if we did not have our savings. But that is almost all gone now.

I for one think it is time that something be done to stop this sort of thing from happening, and you, gentlemen, have the power to do it.

Chairman HEINZ. Mrs. Taylor, Thank you very much.

Senator Grassley has a commitment in the Judiciary Committee. As you know, they are in the process of examining two of the President's nominees to the Supreme Court.

Senator Grassley, thank you for joining us. We know you have to be present in Judiciary as well.

Mrs. Taylor, thank you, and I will have some questions for you and perhaps Mr. Taylor, in a few minutes.

Mr. Harris.

STATEMENT OF LEONARD HARRIS, DAYTON, OH

Mr. HARRIS. First, I want to say that it is a privilege for me to be here on behalf of all retirees. And I appreciate Senator Glenn asking me to come here and testify.

I will start by saying good morning. My name is Leonard Harris, and my home is in Dayton, OH. I am a 56-year-old retired grinder.

Senator Glenn asked me to come here today to tell you about the problems my wife and I have had after my former employer, GHR, closed our Dayton plant in 1983 to move to another State.

At the time of the closing, I thought that 30 years of hard work at the plant had earned me a pretty good retirement. In fact, when we were told about the closing, I had a 30-minute meeting with a woman from the company about this. She said that my benefits would be guaranteed, and that I would receive my $880 per month pension, plus keep all my health and life insurance benefits until I could get Medicare. I had no reason to question her, and I felt fairly good about the meeting and my future.

Later on that year, my wife and I learned that we would be losing our health and life insurance benefits. My wife was sick in the hospital in March 1983, and I got a letter from the company telling me that they were canceling my insurance, which was on March 31. I took my wife out of the hospital 2 days before the insurance was canceled. My wife was sick in the hospital, and I had to take her out. My wife needs lots of medical care. She also has lupus, heart disease, and neurological problems. So you see, we really need help to pay. After that bad news, we received more bad news from a letter which said our pension benefit would be cut almost in half—to $480 a month. That is all we are living on now.

I could hardly believe it, and was so worried, I cried. Since then, my wife and I have struggled to get by. When I got sick 2 years ago, my wife sent me to a VA hospital. They hospitalized me for 21 days because my blood sugar was so high. I am a veteran. I went back to the VA hospital last year, but they said I am not eligible for treatment there anymore because of some bill President Reagan signed.

I know I should be seeing a doctor, but I want to pay anyone who doctors me, so I have not seen a doctor for a year. I have to take care of my wife. She needs the help more than I do, and I will take whatever I can get for her. Our family doctor takes care of my wife without charging us. We are lucky, but I do not feel good about it, and I do not know what we will do if she needs to go back to the hospital.

We now have a lawyer who is taking our case to court. They tell us that we will have our day in court, but they keep pushing the date back. Someday, we might get our court date, but that does not help us now. It does not help us pay for our utilities, our food, or our doctors.

I am hoping that what I have said today can help you help people like me who really do not ask for so much. We only want what we earned—nothing less and nothing more.

Thank you.

Chairman HEINZ. Mr. Harris, thank you very much.

Before we begin questioning, I would like to introduce another very important member of our panel, Senator Pete Wilson of California, for any opening comments he would care to make.

STATEMENT BY SENATOR PETE WILSON

Senator WILSON. Thank you very much, Mr. Chairman.

I have to be in three places this morning, but before going to the markup of the Agriculture Committee, I did want to both thank you for holding this very important and timely hearing and to express some thoughts of my own.

I find it appalling that a number of companies in the private sector that have engaged to provide the kind of health benefits that we are discussing here this morning have, in their effort to reduce their own costs, cut or canceled what are their clear obligations to provide, contracted for, and paid for retiree health benefits. These benefits represent, I am told, the only health care coverage for 3 million retirees under 65 and a critical supplement to Medicare for those who are eligible to receive it. With the exception of those retiree benefits that are prefunded by employers, most are not afforded the protection of Federal law. And as you know, Mr. Chairman, for employees of large companies, continued health care coverage in retirement is a benefit that is promised; indeed, it is a benefit on which millions of Americans depend. However, in many cases, these retirees are finding themselves in their latter years without this critical support they had anticipated they could depend on.

Absent Federal direction in this area, I am afraid the situation will only worsen. It is especially true in our Nation's failing and troubled industries such as auto and steel which, in your own State, Mr. Chairman, you have expressed a great concern for.

Some of these troubled industries have incurred staggering debts as a result of liabilities or retirement benefits, only to find that those whom they had contracted with to provide them are now defaulting on that responsibility.

Companies that file for bankruptcy or choose to reorganize their debt often opt to terminate retiree pension, health and life insurance plans and leave employees who had expected that kind of coverage with nothing. Retirees left in bankruptcy court fighting for their own health benefits are in many cases fighting against very difficult odds. Without congressional action or some other provision of statutory protection, these retirees are often really at an unfair disadvantage, and the result all too often is that they wind up without coverage.

So I think that it is tremendously important, Mr. Chairman, for you to be holding these hearings. Employers, we know, can easily place limits on the contracts; they can release themselves from an obligation to pay. Many have, or we would not be here today. Many private companies are simply defaulting on their responsibility.

It is unfortunate that we need to be involved, and I think Congress has a responsibility to assist in providing some remedy for those threatened with such unremedied breach of contract.

In this case, retirees are really at the mercy of circumstances beyond their control. I think that contracted and paid-for retiree benefits must be made more secure. Obviously, we are required to act with care. We are talking about employers who in most cases have either chosen voluntarily or through collective bargaining to assume the obligation to provide such benefits. We have to exercise care in a complex area that we not impose such onerous or stringent burdens upon them that they choose some other method of satisfying the requirements of collective bargaining or choose to withdraw from participation.

So I thank you, Mr. Chairman, for having convened the hearing, and pursuing it. I will read the record with great interest and look forward to the committee's deliberations.

Thank you.

Chairman HEINZ. Senator Wilson, thank you very much.

I will also note that the Senate is in session, and there is a bill that you have some responsibility for that is on the floor of the Senate as a member of the Armed Services Committee, so you have at least three things to do today.

Senator WILSON. At least. Thank you, Mr. Chairman.

Chairman HEINZ. Thank you very much for being with us.

Well, let me somewhat parochially begin with my constituents, the Taylors, then I will have some questions for Mrs. Grimaldi, and I imagine Senator Glenn would like to particularly pursue the situation of Mr. Harris.

Mr. and Mrs. Taylor, you stated that you are even now just not sure what is going to happen to you. You have read things in the paper. To what extent has the LTV Corp. communicated with you, at any time since July 17, to let you know where you stand?

Mrs. TAYLOR. Very little. One time.

Chairman HEINZ. And when was that? What was that about?

Mrs. TAYLOR. That was on the 18th, when they mailed the letter stating that they would no longer carry medical coverage or life insurance.

Chairman HEINZ. So officially, all you know is that you do not have health care coverage. You have read in the papers that it has been reinstated for 6 months, but you have not had any notification as yet.

Mrs. TAYLOR. No.

Chairman HEINZ. Have you sought any medical care from a hospital since you learned in the paper that your medical benefits have been reinstated?

Mrs. TAYLOR. On July 24, he went in for another checkup, and the hospital said, "Don't worry about it. We will take care of it."

Chairman HEINZ. They did; so that was not a problem.

Mrs. TAYLOR. Right.

Chairman HEINZ. Now, you stated in a way that should be of concern to everybody what your monthly living expenses are. I totalled them up very roughly, and including that $56.27 that you have to pay for medication, it comes to roughly $400 a month and that excludes, as you pointed out, food, clothing, and your heating oil bills which can be absolutely back-breaking at times, depending on how cold the winter is or how expensive oil is. We all read where it is going back up again.

Your income, as I recollect, was roughly $357 a month; is that right?

Mrs. TAYLOR. That was until September 1985, and then he went on regular Social Security disability, which was $726, which is now $746.

Chairman HEINZ. And does that cover all of your expenses, or not?

Mrs. TAYLOR. Not if I have to buy medical coverage.

Chairman HEINZ. Have you tried to buy medical coverage?

Mrs. TAYLOR. The last time I had a quote for medical coverage from Blue Cross and Blue Shield in Pennsylvania, it was over $500 for a 3-month period.

Chairman HEINZ. So $500 a quarter.

Mrs. TAYLOR. Right.

Chairman HEINZ. Or about $166 a month.

Mrs. TAYLOR. Right.

Chairman HEINZ. And what kind of deductibles and copays—were there any deductibles or copays, or was that 100 percent——

Mrs. TAYLOR. There were no deductibles, no copayments, except for the major medical, where they paid 80 percent.

Chairman HEINZ. Eighty percent.

Mrs. TAYLOR. Eighty percent.

Chairman HEINZ. So if you had a hospital bill of $5,000, you would have to pay $1,000 of that, wouldn't you?

Mrs. TAYLOR. No.

Chairman HEINZ. You would not?

Mrs. TAYLOR. No; that was just on the major medical. All the hospitals, doctors were covered, totally.

Chairman HEINZ. I see. Now, if LTV should 6 months from now decide that they cannot afford to pay benefits, or if a creditor goes to the judge this week, next week, and convinces the judge that they are more important than you are—and that could happen, ironic or wrong as that might be—what would your situation be? You mentioned that you had some $29,000 in hospital bills in the last 2 years?

Mrs. TAYLOR. That includes just hospital bills. That is not the bills for the tests that were done, for the 31 CAT-scans and what-have-you. That was only hospital in-patient bills.

Chairman HEINZ. So you would really be in terrible shape, wouldn't you?

Mrs. TAYLOR. They could have my house, period.

Chairman HEINZ. You know, I think the reason we all feel such frustration is that you and your husband, as I understand your situation, have tried to do everything that we as Americans ask people to do. You have worked hard, whether it has been in a factory or in a home. You have tried to save. You have tried to be economical. You have tried to do things the way your parents, our parents, taught us to live, and all of a sudden, what little it was you thought you had in the way of a security blanket has been snatched away from you.

When we use the phrase "leaving people out in the cold," to leave them without any health insurance and throwing them into a situation where it could be very difficult even to get health insurance, let alone afford it if you are not a member of a group, is grossly unfair.

I see my time has expired. I will have some questions for Mrs. Grimaldi in a minute.

Excuse me. May I recognize Senator Dodd. Senator Dodd, you have a very valued constituent here in Mrs. Grimaldi, who has testified, and I want to recognize you for any comments you wish to make.

STATEMENT BY SENATOR CHRISTOPHER J. DODD

Senator DODD. Well, thank you, Mr. Chairman. We appreciate your comments, and I am delighted to welcome Mrs. Grimaldi and the other witnesses this morning and to thank you, Mr. Chairman, for holding these hearings to try to focus some attention on the issues as you properly described them.

We have heard an awful lot lately about the whole notion of privatization in a number of areas. And certainly, there is a great deal of merit, I think, to explore privatization in certain areas where we can assume a greater responsibility for taking care of people's needs. But I think these hearings here this morning and the testimony from our witnesses highlight the fact that if there is an overreliance on privatization, then we run the risk of what we have seen unfortunately in the tragic situation of LTV.

There has been discussion about privatizing Social Security. Some people have raised that as an option as a way of dealing with the problems. And I really think we have got to make people aware that while, as I said at the outset, there is some benefit in looking at that, we jeopardize an awful lot of security for people if we move in that direction far too rapidly.

I recently read a quote in the National Review from columnist John McLaughlin. He says:

> Privatization is an idea whose time has come and with proper vigilance can be implemented with no threat to national security or public safety, no termination of necessary services, and no discrimination against minorities or the poor.

Well, we have seen in the situation here that relying exclusively on private benefit plans can in fact create serious difficulties and problems.

So Mr. Chairman, I would ask unanimous consent that an opening statement be included in the record.

Chairman HEINZ. Without objection.

Senator DODD. And again, I would express my gratitude to you for focusing your attention on this particular issue of retirement benefits, health benefits, and to welcome Mrs. Grimaldi from Norwalk, CT, who has come down, and has a reputation, I might add, as you will find out shortly if you have not already, of not being shy. Let me put it that way. She speaks out very loudly and clearly on a whole host of issues, including this one.

Chairman HEINZ. She demonstrated that extremely well in her opening statement.

Senator DODD. And you will see more of it. So I welcome you again. We thank you for being here, and I thank you, Mr. Chairman.

Chairman HEINZ. Senator Dodd, thank you very much.

[The prepared statement of Senator Dodd follows:]

PREPARED STATEMENT OF SENATOR CHRISTOPHER J. DODD

Good morning, Mr. Chairman. I want to commend the committee for drawing attention to the problem of terminations of retirees' earned health benefits. I know that you and the staff have been focusing for some time on ways to insure that retirees actually receive the health insurance coverage which was part of their benefit package, in ways which do not strain the financial capacities of their employers to continue in business. It is tragic that this focus should so suddenly be sharpened by the LTV bankruptcy and the company's abrupt termination of health benefits for its 78,000 retirees. While the temporary respite granted by the six-month restora-

tion of those benefits is welcome, we must find a permanent mechanism to address this problem. It is unacceptable that men and women who retired after faithfully contributing to their companies' past successes should find themselves bereft overnight of so vital a necessity as health insurance protection.

We have heard much over the past several years about the merits of privatization and the abundant blessings which must flow from the withdrawal of Government from any substantial role in our national life, other than defending our country. There are those who see transcendent virtue in transferring Federal properties like the strategic petroleum reserve, or programs like Social Security, to the private sector. In an article in the National Review on February 28, 1986, columnist and commentator John McLaughlin stated:

* * * (Privatization) is an idea whose time has come, and with proper vigilance can be implemented with no threat to national security or public safety, no termination of necessary services, and no discrimination against minorities or the poor.

Mr. Chairman, the plight of the witnesses in our first panel stands in stark contradiction to that contention. I admire and salute the accomplishments and vigor of our private sector. The generally robust economic condition of my own State of Connecticut stands as a tribute to effective business performance. However, the changing economic winds of the marketplace can buffet individual businesses or entire industries; and the most generous intentions of employers are thwarted by a fundamental loss of competitive position. When this occurs, I believe that Government must play a role in protecting the livelihood—indeed, the survival—of the men and women who devoted their working lifetimes to their employers and industries. I would invite the attention of those who applaud absolute privatization to the testimony we will be hearing this morning, from people who suddenly and unexpectedly found themselves without the health benefits which they were promised, at a time when those benefits were literally a matter of life and death. Most retirees in this situation do not have the option of easily finding an insurance company willing to underwrite a health policy for them. If they did, they couldn't afford the premiums, which would probably consume a major share of their pension checks. Indeed, the pension checks themselves might also be vulnerable to reduction due to the same straitened circumstances which caused their employers to drop retirees' health coverage.

With the enactment of ERISA in 1974, the Government for the first time and rightly assumed a role in guaranteeing pension rights in the private sector. It may be time to consider extending similar protections to earned health benefits. This committee is taking a laudable first step in determining whether we have reached that point, and in exploring how such protections might best be crafted and implemented. I look forward to the recommendations of the witnesses regarding these important points.

Chairman HEINZ. Senator Glenn.

Senator GLENN. Mr. Harris, in your statement you said you worked at one plant for 30 years; that the plant closed and moved to another State; that a woman from the company carefully explained the pension, health and life insurance benefits you would receive until you became eligible for Medicare; is that correct?

Mr. HARRIS. That is correct.

Senator GLENN. Did she give you any indication at all that these benefits might be reduced at some time in the future?

Mr. HARRIS. No, she did not. When I went in there, she spread the papers out on the table, when I went in there to sign up for my retirement, and she spread them out and explained all this to me. As I went along, I asked her questions. I said, "Is the insurance guaranteed for me until I get to age 60?" She said, "62 or 65, it is guaranteed." I said OK, and I signed it. Then my money, she said that is guaranteed for life.

Senator GLENN. Now, you are 56?

Mr. HARRIS. A 56-year-old, old, wornout foundry worker, and I cannot get a job.

Senator GLENN. You are in a situation where Medicare does not cover you yet.

Mr. HARRIS. That is right.

Senator GLENN. And so you are one of these difficult cases that is in between. You have had your benefits wiped out.

Mr. HARRIS. Yes, sir.

Senator GLENN. Your wife has diabetes, and both of you have lost your health insurance benefits, and you just cannot afford to keep her in the hospital.

Mr. HARRIS. No, sir. She needs to be in there now.

Senator GLENN. I noticed you were using your glasses a lot when you were reading there, and putting them back and forth. Now, you have diabetes, and one of the things with diabetes——

Mr. HARRIS. Yes, sir. You can see, I have one stem where I am not able to have them fixed. But I hold them up on my face.

Senator GLENN. And one of the difficulties with diabetes you have is that it does affect your eyes. You can get glaucoma, and you should have your eyes checked very regularly.

Mr. HARRIS. Yes.

Senator GLENN. Have you had your eyes checked recently?

Mr. HARRIS. No, not since last year when I had them checked at the VA.

Senator GLENN. Were you a union member at this plant?

Mr. HARRIS. Yes.

Senator GLENN. What did your union say about this, about your loss of benefits? Are they representing you in this?

Mr. HARRIS. They did represent us in this. The union filed a suit against the company on behalf of all the benefits. The company closed the plant down before the contract ran out. They closed the plant down in January 1983, and the contract did not run out until June 1983.

Senator GLENN. Has the union filed a suit against the company?

Mr. HARRIS. Yes.

Senator GLENN. And that is before the National Labor Relations Board now?

Mr. HARRIS. They filed a suit against the company, and they won suit against the company three times. The Labor Relations Board demanded the company to start paying. The company turned around and appealed it again and came to Washington, and they had a three-judge panel. And the three-judge panel threw it out.

Senator GLENN. Well, your case is just so typical of things that we are running into on this—where we need additional legislation in some way. And I do not know exactly what it is.

We are in a position now where, under some of the budget-cutting procedures that we have set in Washington—that I disagree with strongly; I am as dedicated opponent of the Gramm-Rudman approach to things as there can be here—your possibility of getting help is cut. Now, it was protected a little bit from the full cuts, but it will still be cut by, I understand, 2 percent or something like that.

But over the course of this administration, the budget-cutting for VA and for things like that has gone on, you cannot even get the help from the VA that you normally would have gotten.

Mr. HARRIS. Well, that is another slap in the face; I found out that, too. I was in the VA the first time for 21 days, and they gave me medical care. I went up there for at least 6 months, and then

they cut me loose. That is when they cut me loose on account of the bill was passed. They were cutting, and if it was not service-related, they were cutting them loose, and I was one of them that they cut loose.

Senator GLENN. Well, I am critical not only of companies in this case, but I am also critical of unions for writing these contracts and agreeing to things that sound like pie in the sky. They are great, but there is no protection for getting those benefits paid in so that they are vested, so that the money is paid in each year, and you know exactly what you have, and it is not dependent on future earnings of the company.

So there is plenty of blame to go around here, and blame at the Federal level, too. I think this committee above all committees on Capitol Hill has a responsibility for seeing that we try over the next few months or the next year to certainly do something about this.

I personally favor some sort of catastrophic health insurance, and I favor something where on these contracts, they have to pay into some sort of a fund that cannot then disappear when a company goes downhill. We cannot expect companies to always be profitable. And yet we write some of these contracts that are pie in the sky, and it sounds great at a time when the company is expanding, but then trade conditions change, or something changes, and the company cannot make it anymore. They sell out or something happens, and the benefits disappear, and people like yourselves are left hanging.

Somehow we have to change this, because it is too important for you, and you are typical, and I appreciate very much your willingness to come in and tell your story. And we should have welcomed Beverly, your daughter who lives here in Washington, with you today. We are glad to have you with us, too.

Thank you much.

Mr. HARRIS. Thank you.

Chairman HEINZ. Senator Glenn, thank you.

Senator Dodd.

Senator DODD. Thank you, Mr. Chairman.

Senator Glenn has very eloquently pointed out the frustration that all of us feel, I think, in dealing with the issue, and I think he is absolutely correct. I think too often there is an assumption that businesses that are in place and healthy and doing well are going to be that way forever, and that there will not be mergers and acquisitions and new management that comes in and takes on different positions.

I think, Mrs. Grimaldi, in your case that was one of your problems. You had a company where your husband had worked in Stamford for a number of years that was owned by one operation, and they were the ones who made the commitments with regard to health insurance, and then you had an acquisition by Teledyne, which then, as you pointed out in your testimony, closed its doors and cancelled these policies. And that is not something you can predict with any certainty down the road.

Mrs. GRIMALDI. That is right.

Senator DODD. The thing that I found most disturbing and most telling, I think, Mr. Chairman—and I am sure everyone heard Mrs.

Grimaldi's testimony—is that you did not actually receive notice until 1 month after—after—your benefits had been canceled.

Mrs. GRIMALDI. Right.

Senator DODD. And there, there is no excuse whatsoever. We can decry what happens when the entire program, or a company closes its doors. But what justification were you given by the company for not notifying you or your husband prior to cancellation of that contract so that you could take steps to protect yourselves?

Mrs. GRIMALDI. None.

Senator DODD. Did they ever give you an explanation as to why they did not let people know?

Mrs. GRIMALDI. No. They were "just a little late in sending out the letters." This was the excuse extended to me. When I called Mount Vernon Die, Teledyne, and asked to speak to the young lady who had typed the letters, she was nowhere to be found, and could not, would not, be available to us. They gave no excuse whatsoever, except that the mail was late in getting out.

Senator DODD. A month late?

Mrs. GRIMALDI. A month.

Senator DODD. Just for my own edification, what would you and your husband have done differently had you been aware that this was going to occur?

Mrs. GRIMALDI. Well, I honestly do not know. I mean, we felt so secure in our position at that time. And to suddenly learn that the company was picking up stock and moving off to Chicago—this was one thing in our favor, of course. I called the union immediately, and I asked them what we could do, and my husband and I initiated the case against Teledyne. We never went to court. And fortunately, we had a wonderful crew of people working for us.

But what would I have done had this not succeeded? Do as I am doing now—pray a lot.

Senator DODD. How much money had you and your husband saved?

Mrs. GRIMALDI. About $30,000 at that time.

Senator DODD. You had accumulated that in a savings account that you had put away, little by little?

Mrs. GRIMALDI. Yes, yes.

Senator DODD. Of that $30,000, how much did you expend on medical costs and other charges?

Mrs. GRIMALDI. The records that I kept—certainly, there were many that I did not keep—totaled about $14,000 during that 4-year period.

Senator DODD. That you expended.

Mrs. GRIMALDI. That I expended.

Senator DODD. That would have been otherwise picked up had the coverage been in effect?

Mrs. GRIMALDI. Yes. We had Blue Cross, just Blue Cross for hospitalization, until I went into the hospital for my first surgery. I was not aware and was not made aware by Teledyne that this was available to us. And I learned then that we could, yes, get medical help, but it was merely supplementary. We paid $900 a year for this privilege. It depended solely upon what Medicare would allow. For example, in the case of that anesthesiologist, $800 I paid; $200 Medicare approved. They paid 80 percent of that, and then Blue

Cross/Blue Shield would pick up the balance. However, at that time, I did not have that additional insurance, and it was extremely difficult for us because as you can see our income was not such that we could afford more.

I was fortunate in one sense. If my husband had to have his heart attack, it happened a month after we made our last mortgage payment. And we have been able to keep our heads above water. Our children have been generous—if they had not been so generous, I do not think we could have made it.

Senator DODD. But for years, you counted on——

Mrs. GRIMALDI. Very difficult. And I feel for all the people who have been in the same predicament that I have been in. I could not go back to work. My husband is a cardiac patient. I could not leave him alone. He had cardiac arrest back in 1985, and that was the shock of my life because the doctor had just told me that in all his profession, he had not seen a case that had not progressed in 10 years, and that I must be doing something right. He went in for a stress test, and praise the Lord, I must tell all of you, if ever you need a stress test, go to a hospital to have it done, because if you do it in your doctor's office and he goes home and 6 hours later dies, you will not have your loved one with you. And this is what happened to us. He had a stress test. Six hours later, we were sitting in the hospital room, talking, and my husband died. And I screamed. They did not need to look at that monitor to see what was happening. They heard me. And within 10 minutes, he was back. They dislocated both his shoulders. He is not able to do anything now. And praise the Lord, if anything happens now, we are fully covered with major medical. And one of the agreements that Teledyne has made is that they will never withdraw this from us again. And we are hoping and praying this is true.

Senator DODD. Well, I appreciate again your being here this morning—all of you being here—and sharing your stories with us.

And again, I do not have any, nor do I think anyone has a specific piece of legislation or an answer to this yet, but clearly, something must be done here to secure greater accountability. You are not isolated cases. That is the tragedy of this. And as I mentioned at the outset, my concern is there seems to be this general thrust toward getting the Federal Government out of this business altogether. And I am not suggesting we ought to get into the middle of it and try and supplement it somehow, but it seems to me we ought to play a far larger role in trying to protect those agreements that most people assume they have. And to that extent, I am confident we will be able to do something along the lines which Senator Javits and others worked on a number of years back with ERISA, with pension benefits and the like. So I look forward to working with the chairman, Senator Glenn and others on that.

Again, I thank you for coming here this morning.

Thank you, Mr. Chairman.

Chairman HEINZ. Thank you, Senator Dodd.

I would just like to observe and draw to the attention of our witnesses today, both this panel and others and interested observers, the committee staff report which has been made available. On page ii and also on page 18, there are a series of staff recommendations on how to secure funding and how to guarantee access, how to re-

quire notification and also to study some additional options that we believe are worthy of consideration.

One of the ironies is that last year, in the Comprehensive Omnibus Budget Reconciliation Act, which is often referred to as "COBRA"—sounds like something that would bite you—in fact, we paid specific attention to the problems of unemployed workers. Under this legislation which became fully effective with respect to the provision I am about to mention on June 30 of this year, employers are required to offer to their laid-off employees—not their retirees, but their laid-off employees—continuation of their health insurance benefits at the plan cost, thereby substantially reducing the cost of health insurance from some $500 per quarter that you, Mrs. Taylor, and your husband would have to pay for nongroup coverage from Blue Cross/Blue Shield.

It is ironic that we did not at the time this legislation was being written focus on the potential plight of retirees. You do not have the right currently to do what unemployed laid-off people can do, at least for the 18 months that has been guaranteed as an access period to these laid-off employees.

My question to you, and this is really aimed specifically at the Taylors, if you were able to continue coverage under the LTV plan but had to pay for it as we have allowed unemployed workers to obtain coverage, if that was all that had been available to you, would that be helpful, or would you still be in a serious financial bind?

Mrs. TAYLOR. We could manage—we would have to manage.

Chairman HEINZ. You think you might be able to get by. It would be tougher than not having full coverage.

Mrs. TAYLOR. Well, seeing as Mrs. Taylor cans all her own vegetables, and all I buy is meat at the grocery store.

Chairman HEINZ. You are an expert on mason jars.

Mrs. TAYLOR. Right—freezer bags, too. We could get by. It would not be easy, but we could get by.

Chairman HEINZ. It would not be as good as having your benefits, but it would be better than being left out in the cold as Mr. Harris and Mrs. Grimaldi have been for a period of time.

Mrs. TAYLOR. Right. It would be better than nothing.

Chairman HEINZ. Well, I want to thank all of you. You have been outstanding witnesses. I think you have made very clear the different kinds of circumstances.

Mrs. Grimaldi, you have pointed out the situation where you have prevailed, after a long battle, and you got your benefits back. But that company is not a bankrupt company; it is an ongoing, profitable company. Teledyne simply shut a plant down.

The Taylors have a different situation. Their company is in bankruptcy, and it is unclear what is going to happen.

In the case of Mr. Harris, he has really testified more than anybody to what happens when you do not have any place to turn. He and his wife are going without health care coverage right this moment in a way that is genuinely dangerous to their health and, in my judgment, life threatening. Anybody who has diabetes should be carefully checked, and he and his wife have other ailments.

Mr. Taylor and his wife could be in the future, in a life-threatening situation, unable to get, should he need it, chemotherapy.

Mr. TAYLOR. I would drop it.

Chairman HEINZ. You would drop the treatment because you would not want to impose that kind of financial burden on your wife and yourself. You could not afford it.

Mr. TAYLOR. Yes, sir. Before I would jeopardize what I have, I would drop it.

Chairman HEINZ. I want to thank all of you.

I do want to recognize, though, Senator John Warner of Virginia, a very valued member of this committee, for any comments or questions he may want to make.

STATEMENT BY SENATOR JOHN WARNER

Senator WARNER. Thank you, Mr. Chairman.

I wish to have my statement included in the record.

Chairman HEINZ. Senator Warner, without objection.

[The prepared statement of Senator Warner follows:]

PREPARED STATEMENT OF SENATOR JOHN WARNER

Mr. Chairman, I congratulate you on the timeliness of this morning's hearing. The chapter 11 bankruptcy filing of LTV corporation on July 17 terminated health insurance coverage, without warning, for some 78,000 company retirees. Although the temporary continuation of health insurance coverage has now been ordered, largely due I might add to your prompt legislative response, we have no long term solution for these and other similarly affected retirees.

The lack of protection for retiree health insurance coverage appears to be a problem which has been growing for some time, and one which has not, until the LTV action, been a principal focus of Congress. It is disturbing to learn that either through bankruptcy proceedings, corporate take-overs or plant closings, career employees and their families may abruptly be denied company health insurance in their retirement years.

Without specific protections in Federal statute, the matter has been left for the courts to decide. We do know that contractual and collective bargaining agreements are normally honored, but if legal agreements do not explicitly provide for retiree health insurance, there is no guarantee that it will be continued.

According to the Aging Committee staff report released today, we have in this country 4.6 million retirees and 2.3 million dependents participating in company health insurance plans. Of these, approximately 3 million are under the age of 65 and totally reliant on company coverage to carry them until reaching Medicare eligibility. After 65 and Medicare, the remaining 3.9 million are relying on supplemental company health insurance to make ends meet where Medicare protection stops.

There are a number of forces working to endanger continued group health insurance coverage for retired employees. To begin with, the retiree population is growing and, particularly with long-established companies, retirees often outnumber active workers. Plus, we have ever escalating increases in the costs of health care, which together with the growing number of possible retiree claimants have undoubtedly caused employers to speculate over their future liabilities. For companies faced with financial difficulties, the pressure to reduce labor costs leaves retiree health insurance as a likely target for belt-tightening.

Adding to the problem is the fact that the situation is just going to get worse. Every year Medicare requires greater out-of-pocket expenses by beneficiaries, requiring greater dependence on supplemental health insurance by all categories of retirees. Health care price inflation, although slowed, is still not under control and may never be.

Mr. Chairman, I know this matter is of particular concern to you as well as our ranking member, Senator Glenn. Between you, you have a large part of the vast retiree population of America's troubled smoke-stack industries. If LTV is the "tip of the iceberg", I hope that we have seen it in time.

Congress now has an opportunity to address retiree health insurance protections, and I am pleased to see the recommendations already proposed in the Aging Committee staff report. My main concern is that we don't, as the saying goes, "cure the disease and kill the patient." If a company is presented with a Federal mandate

stating that the option of retiree health insurance must be a lifetime provision, the company may well not take up the option at all.

I believe we have a balanced set of proposals to start from, and I am looking forward to an active interchange in today's proceedings. This will be the work of many months, but the safeguarding of retiree health insurance benefits more than deserves our best efforts.

Chairman HEINZ. If there are no further questions, let me thank all of you for the distances you have come and for the great contribution you have made to this committee.

Thank you all very much.

Mrs. GRIMALDI. Thank you.

Mr. HARRIS. Thank you.

Mrs. TAYLOR. Thank you.

Chairman HEINZ. Let me ask our next panel of witnesses to come forward, please: Neal Dudovitz; Willis Goldbeck, accompanied by Timothy Ryan; and Douglas Baird.

Gentlemen, let me ask you to please proceed. Mr. Dudovitz, you are our first witness; then we will go to Mr. Goldbeck and Mr. Baird.

Neal, welcome.

STATEMENT OF NEAL S. DUDOVITZ, DEPUTY DIRECTOR, NATIONAL SENIOR CITIZENS LAW CENTER, LOS ANGELES, CA

Mr. DUDOVITZ. Thank you, Senator Heinz. And I want to thank you for inviting me to be here this morning.

I have, as you know, submitted some written testimony, and rather than read that, I would ask that that be entered into the record. I would also like to make a few comments and paraphrase some of that testimony.

Chairman HEINZ. Without objection.

Mr. DUDOVITZ. I am, as you know, with the National Senior Citizens Law Center, which is a Legal Services Corporation and Administration on Aging-funded national support center.

I approach this issue from the perspective of having represented hundreds if not thousands of retirees over the past 11 years, who have either not received their pension benefits or their health benefits. And so I have worked with and tried to help people like the past witnesses, who I think very eloquently set forth the problems they must confront when health benefits are eliminated.

I think it is important also to recognize, as you noted, Senator Heinz, in your opening statement, that the courts to this point have often protected these people's rights. I think Mrs. Grimaldi's statement of her experience illustrates that point.

One of the problems, however, is the lack of notice that has been discussed here today. People may be able to protect their rights if they have an opportunity to do so. Cutting off someone's health benefits and telling them after the fact does not protect them very long. In fact that is what happened to Mrs. Grimaldi; she had to go through a great deal of anguish for a number of months before she received what she was entitled to all along.

So one of the things I would definitely urge the committee to consider is at least requiring advance notice to people before their benefits are reduced or terminated. They may have a contractual

right to protect those benefits which can be enforced if they know about it in advance.

Also, while that contractual right may be useful now and has been in the past; unfortunately, it is probably less likely to be useful in the future. Once employers understand that if they put the right words in a contract they can terminate or reduce benefits, people are again going to be left out in the cold.

So I think it is critical that Congress try and address this problem soon, because all new contracts are probably going to be worded in such a way as to allow the termination or reduction of benefits.

There are three additional points that I would like to make or suggestions for Congress and this committee to consider. One is that it is very important to recognize that these benefits are a form of deferred compensation, just like pension benefits. Essentially, it is part of the wage package. When you get hired, you give up part of your current compensation in order to have guarantees for the future. You do the work, you complete your part of the bargain; you have given up something now for something later. And then after the fact, the employers try and take it away.

It is important to recognize the principle of deferred compensation in this context. It is after all the heart of ERISA's pension protections. Pensions are a form of deferred compensation and so are health benefits. They are equally part of the wage package.

Second, and related to the deferred compensation principle, I urge Congress to adopt some form of vesting of health benefits. It would be best if that corresponded with the funding of health benefits. After all, vesting, if there is no funding, may be vesting in nothing. But even some vesting is better than none, because some of the problems are not just bankruptcies, as the people who preceded us illustrated. Some are reductions; some are changes. Sometimes there is money to back up the benefits if there is a vested right.

The courts have refused to call for vested rights of health benefits. They have said very directly, that is up to Congress to determine that issue. So I would urge Congress to act now.

Finally, I would suggest you consider changing or amending some of the Federal labor laws to require that the rights of retirees be a mandatory subject of collective bargaining. Some of these problems now before this committee stem from the fact that the Supreme Court held about 15 years ago that retiree rights are not a mandatory subject of collective bargaining. Unions and employers, when we have a unionized industry, do not have to pay attention to retiree rights. They can exclude retirees. They can write the kinds of agreements that Senator Glenn was talking about which say the retirees' benefits can be unilaterally terminated. Retirees have no place in that system, and unions have no obligations to those retirees in a legal sense.

You must keep in mind the lack of bargaining power, if you will, of retirees who face this situation. Their bargaining power was while they were working. That is the time when they had some ability to control the wage package. But it is a different matter when you take people who are either too old to go back to work or it is too late for them to build up enough savings. Those persons

have already made a bargain, and they have already done everything they are supposed to do to carry it out. Yet when employers cancel health benefits they are left out in the cold. They have no place to go, they have no power left in the system. And they are stuck either without benefits, without medical care, or maybe if they are lucky, they can have the Government pay their bills through Medicare and Medicaid.

Again I thank you for having me here, and I would be happy to answer any questions.

Chairman HEINZ. Mr. Dudovitz, thank you very much.

[The prepared statement of Mr. Dudovitz follows:]

TESTIMONY OP

NEAL S. DUDOVITZ, Deputy Director

NATIONAL SENIOR CITIZENS LAW CENTER

Before the

UNITED STATES SENTATE

COMMITTEE ON AGING

August 7, 1986

My name is Neal S. Dudovitz and I am the Deputy Director of the National Senior Citizens Law Center (NSCLC). As you know, NSCLC is funded by the Legal Services Corporation and the Administration on Aging as a national legal support center. With offices both in Washington and Los Angeles we provide consultation, advice and advocacy assistance to legal services attorneys and Older Americans Act legal programs throughout the United States.

Since we were founded in 1972, NSCLC has placed a high priority on protecting the retirement benefits of older persons. In 1974, we worked with the Congress to help insure the passage of the landmark Employee Retirement Income Security Act (ERISA). Over the past 14 years, we have also represented thousands of retirees in federal courts across the country in an effort to protect their earned entitlement to pension and health benefits.

Personally I have been with the Center and specialized in the area of retirement benefits for the past 11 years. During that time, I have had an opportunity to review hundreds of different benefit plans, and assist numerous lawyers in counseling and representing their elderly clients who have been denied retirement benefits. Unfortunately, I have also had many occasions to witness the injustices which

still remain in our nation's retirement income system and which have not been remedied by ERISA.

One of these injustices, which has become more prominent in the past few years, is the attempt of many employers to unilaterally alter or eliminate their retirees' health benefits. Employers, who have promised their workers lifetime benefits at retirement, suddenly decide to renege on their word. Usually under the guise of saving costs, medical insurance is either drastically reduced or often terminated. Without warning, and contrary to repeated promises, retirees who have worked for and counted on medical insurance to protect themselves and their families are then left to their own devices or must turn to Medicaid and Medicare to meet their health needs. The loss of promised medical coverage for many retirees not only means foregoing needed medical care; it is also often financially and emotionally devastating. Indeed, as this committee is well aware, for many older americans their earned health insurance is often a more valuable benefit than the pensions which accompany them.

Yet, while ERISA offers explicit protections so that employers cannot unilaterally alter or cancel retirees' pensions, the law is silent on retirees' right to continued health benefits. Ironically, ERISA covers health benefit plans only in a general fashion, thereby preempting all

state laws that might aid retirees. But it fails to replace the preempted laws with national minimum rules. In some sense retirees have less protections for their health benefits after ERISA than before the statute was passed.

Many retirees who have lost their benefits in the past few years have been saved by the federal courts. Led by the United States Court of Appeals for the Sixth Circuit, the courts have acted to protect retirees' legitimate expectations. Beginning with its decision in UAW v. Yard-Man Inc, 716 F.2d 1476 (6th Cir. 1983), cert. denied, 104 S.Ct. 1002 (1984), and culminating with its recent ruling in In Re White Farm Equipment Co, 788 F.2d 1186 (6th Cir. 1986), the Sixth Circuit has held that a retiree's contractual right to lifetime health benefits is enforceable. The Court has put employers on notice that contractual arrangements for health benefits, if at all unclear, will be interpreted in favor of the retiree.

Under the court decisions, health benefits can be reduced or eliminated only if the agreement at the time of retirement grants the employer that right in explicit and unambiguous terms. So far, nearly every court that has ruled on the validity of an employer's attempt to reduce health benefits has found that the employers acted illegally and violated the contractual rights of the retirees. See, e.g., Eardman v. Bethlehem Steel Corporation Employee

Welfare Benefit Plans, 607 F.Supp 196 (W.D. N.Y. 1984); Weimer v. Kurz-Kasch, 773 F.2d 669 (6th Cir. 1985); Bower v. Bunker Hill Co., 725 F.2d 1221 (9th Cir. 1984); Policy v. Pressed Steel, 770 F.2d 609 (6th Cir. 1985); Local Union No. 150-A v. Dubuque Packing Co., 756 F.2d 66 (8th Cir. 1985); Musto v. American General Corp, 615 F.Supp. 1483 (M.D.Tenn. 1985).

Despite these current successes, in the long run the federal courts cannot to be the answer to the problem. First, the courts can only solve those particular problems that are brought before them. What happens to the thousands of retirees who have been unable to file expensive lawsuits against well-funded employers to protect their right to continued health benefits? Unfortunately, the courts are helpless to aid those retirees.

Second, the court victories are likely to be only temporary. Sooner or later most employers will heed the court decisions and provide in explicit and unambiguous terms that health benefits can be altered or terminated after retirement. When that happens, under the analysis now used by the courts, future retirees will no longer have a contractual right to lifetime benefits.

Third, the courts themselves have recognized that it is ultimately the role of the legislature, not the courts, to

set our nation's retirement benefit policies. Thus, in the White Farm ruling the Sixth Circuit declined to hold that retirees have a vested right to health benefits. Instead, the court held it was the job of Congress to decide that question:

"We believe that the legislature, rather than the courts, should determine whether mandatory vesting of retiree welfare benefits is appropriate." 788 F.2d at 1186.

In light of these developments, I urge this Committee to consider taking some steps to rectify the current situation. I believe that, unless Congress acts promptly and responsibly, more of our nation's elderly will be left out in the cold with no medical insurance to protect them from catastrophe. I recommend that the Committee consider at least three proposals.

I. Recognizing that Health Benefits Are A form of Deferred Compensation.

For at least the past forty years, policy makers have recognized that pension benefits are not merely gratuities awarded to workers at the end of their careers. Instead, we understand that pensions are a form of deferred compensation for workers. An employee gives up a portion of his current wages and defers it until retirement. In essence, for each hour of work, an employee receives a little less today, in order to have income in the future. This concept of

deferred compensation is, of course, at the heart of ERISA's protections.

Congress must recognize that retiree health and welfare benefits are also a form of deferred compensation. Employers promise those benefits to workers as an inducement to accept a position or continue working. Medical insurance after retirement is in a very real sense part of the wage package. Like pension benefits, workers give up some current compensation for the promise of future benefits. In the terms of Judge Wiseman in the Musto case, an employee has an entitlement to those benefits on retirement based on his or her "sweat equity".

Until Congress makes it clear that retirees have earned their health benefits by their previous work, even the courts will be limited in the protections they can offer to retirees. This basic and fundamental principle of deferred compensation must be the starting point for any action taken by Congress.

II. Retirees Must Have A Vested Right To Health Benefits

In the end, retiree's benefits will not be protected unless Congress demands that employers provide vested rights to those benefits. Retirees cannot rely on the fortuity of the wording of complicated legal documents to protect their rights.

I urge you to consider amending ERISA to provide explicit minimum rules and funding for health and welfare plans which will insure that a worker receives the benefits that he or she has earned. Unless Congress provides leadership now, private employers will be able to continue to dump the medical care of their former employers back on the shoulders of the federal and state governments. The greater the reductions in private medical insurance for retirees, the greater the future costs for Medicare and Medicaid.

III. Retirees' Rights Should Be The Subject of Mandatory Collective Bargaining.

The elimination and reduction of retiree health benefits has occurred in both unionized and non-unionized industries. Unfortunately, the protections afforded to retirees are no different even if there is a collective bargaining agreement.

One of the major reasons for that lack of protection is that the rights of retirees are not a mandatory subject of collective bargaining. This was confirmed by the Supreme Court in its 1971 decision in Allied Chemical & Alkali Workers v. Pittsburgh Plate Glass, 404 U.S. 157. Collective bargainers owe no duty to retirees and are free to reduce, terminate, or ignore the benefits of retirees.

As a result, given their responsibilities to current workers, collective bargainers are often unwilling to protect retirees along with those still working. While this might be a short-sighted response, it often represents the reality of the collective bargaining process.

That reality can be altered if Congress amends the labor laws to insure that the rights of retirees will be a mandatory subject of collective bargaining. Then, at least in unionized industries, retirees will have some protections.

Finally, I would like to thank the Committee for inviting me to testify this morning. Retirees' right to their promised health benefits is a significant problem for our nation's elderly. I am pleased that this Committee understands the urgency of the issue and is willing to seek a remedy.

Chairman HEINZ. Mr. Goldbeck.

STATEMENT ON WILLIS B. GOLDBECK, PRESIDENT, WASHINGTON BUSINESS GROUP ON HEALTH, WASHINGTON, DC, ACCOMPANIED BY T. TIMOTHY RYAN, ESQ., PIERSON, BALL & DOWD, WASHINGTON, DC

Mr. GOLDBECK. Thank you, Mr. Chairman.

I am Willis Goldbeck from the Washington Business Group on Health, and I am accompanied by Tim Ryan who will also be very valuable in responding to any questions that you and your colleagues may have.

We are here not to speak to the particular cases of any individual employers, but rather, I hope to serve as a resource to the committee and to give you an indication of what some of the problems are and what some of the possibilities are in dealing with major employers today.

I think it is very important to recognize at the outset that what you are able to do as Government, or what private employers are able to do in the next few years concerning the specific problem of plan terminations due to bankruptcies or other economic conditions is one set of issues. It is very different than the more generic question of what do we do about providing health care for retirees in America. The vast majority of people who retire from work in America are not faced with this problem at all, because they have no retiree medical benefits; they are not even fortunate enough to have been in a situation from which they could have lost a benefit. And that is by far and away the largest number of people.

Looking at the question of the degree to which Government may wish to regulate retiree medical benefits to protect those who might be terminated, the major caution we would have is do not do something which will simply cause employers to stop providing retiree medical benefits. The numbers who will lose from that restriction are far greater than the numbers who will lose from bankruptcies or other kinds of plan terminations driven by normal national economic ebbs and flows.

In fact, you could say that the work force is responding not unlike the Federal Government in its approach to Medicare; when different Congresses and different administrations and different deficit levels come in, Medicare in essence produces plan changes and many terminations, dramatically affecting retirees throughout the country.

We think very definitely that you want to develop a system in which there are incentives for employers to do more rather than less. So we urge a great deal of caution concerning anything that would eliminate the right of an employer to have some version of plan alteration. The vast majority of plan alterations in the past decade have been benefit plan increases. One of the pages in our testimony lists some 12 to 15 different essential elements of a well-designed retiree medical plan, all of which are plan changes in the form of additions in the last 10 years. None of those would have existed if the law had said the company cannot change the benefit plan once it has been offered.

The magnitude of the economic conditions facing employers is one that suggests the real challenge here is whether or not employment itself is the best vehicle for the financing of medical benefits, for people who no longer are expected to live a few years at most past work; but rather, are living in a state of retirement, not necessarily illness or even being elderly, for periods of 25 and more years. Many of the retirees today that face the greatest problems are in their early fifties and are not in the part of life that we have normally thought of as being provided for in a state of financial or medical desperation. We have no funding vehicle in single companies, nor any yet developed in the Federal Government, to fund millions of people who will be living for 20 and more years. So, we are facing a very different kind of demographic and economic issue.

It would be foolhardy to suggest that any law, any change that might be contemplated now, can guarantee protection for someone who may retire 40 or 50 years from now. Corporations such as the Heinz Corp. that hire a 29-year-old female today, if she lives an average life expectancy, will have just picked up a retiree medical benefit obligation, on average, to the year 2034.

There is no plan that we can articulate that guarantees what that company or any other company will be in terms of economic conditions in the year 2034. And that is just for today's new obligation, much less what they would incur over the next several years.

So the magnitude of these problems that you are trying to address is very, very extensive.

It seems to me there is a great deal of interest in the corporate community today in the prefunding issue. There is also great variability, and that needs to be recognized, in the employer response to these issues. Some companies are actively seeking methods to prefund. Others do not wish to. There is not a uniform corporate posture on these issues any more than there is a uniform corporate retiree benefit plan. There is no law that requires employers to provide medical benefits to begin with, for retirees or others.

I was struck by Senator Glenn's comment about 31,000 people in the State of Ohio who have lost their retiree medical benefit plans. There are many, many times that number of workers who have never had health insurance period in the State of Ohio—another complicating factor when you look at the indigent care issues in a more broad vein.

So let me wrap up these comments by simply noting that I think you will find certainly our organization and a great many others in the country who are desirous of working cooperatively with the committee on the design of plans that will address these issues in a segmented fashion, dealing with those who have problems of plan termination, setting up mechanisms to address their immediate needs so individuals do not fall through the cracks, and recognizing that those needs are very different from the systemic changes that we need to have to secure health access and protection for healthy aging in America.

Thank you.

Chairman HEINZ. Mr. Goldbeck, thank you very much.

[The prepared statements of Mr. Goldbeck and Mr. Ryan follow:]

Washington Business Group on Health

RETIREE MEDICAL BENEFITS

ISSUES AND TRENDS

Testimony Presented to

Special Committee on Aging

U.S. Senate

by

Willis B. Goldbeck
President

Washington Business Group on Health

Accompanied by

Timothy Ryan, Esq.
Pierson, Ball and Dowd

August 7, 1986

229½ Pennsylvania Avenue, S.E. Washington, D.C. 20003 (202) 547-6644

My name is Willis B. Goldbeck, President of the Washington Business Group on Health (WBGH). It is my pleasure to be accompanied by Timothy Ryan, a nationally recognized legal expert in health benefits who works with the firm of Pierson, Ball, and Dowd. Mr. Ryan serves as Special Counsel to the WBGH. His overview of an employer's right to modify health and welfare benefits for active and retired employees is included as an appendix.

Mr. Ryan's statement has been provided to the WBGH for the consideration of our members. As such, it does not represent our position but rather the highest quality advice available for our members. It is provided to the Senate Special Committee on Aging in the spirit of sharing all available information and Mr. Ryan has graciously agreed to be with us here today to respond to any questions you may have. WBGH staff will inform the Committee staff of our members' reaction to the paper as soon as possible.

We are here today because this committee is addressing an issue of great importance to every member of the WBGH. We are the only national organization created by major employers to address the broad range of health policy and health economic issues. The need to seek effective and creative ways to provide needed health care for older Americans compelled us to establish, two years ago, the WBGH Institute on Aging, Health and Work. Our Institute has been supported by member companies seeking help in the design of affordable retiree medical benefits and information about the legal and legislative issues they face. Part of our charter is to serve as an information resource for Congressional committees and Executive Branch agencies. To this end, at the request of your counterpart committee in the House, WBGH conducted a detailed employer survey last year to gather background data and record employer attitudes; we are about to do the 1986 survey to detect changes in trends; we provided the Senate Finance Committee with a review of Retiree Health Benefits: Issues and Options in September 1986; and we are currently conducting a

project for the Administration on Aging to assist state and local agencies on aging to establish cooperative projects with local employers. The first project is now underway in New Jersey and others will be started throughout 1986-87.

This introduction is provided so you will appreciate that we appear before you today in order to be helpful in your examination of this difficult issue. We are not here to represent, defend or attack any specific employer. Nor, as an employer organization, can we claim to have "the" answer: you are addressing a truly societal problem that cannot be resolved by employers alone and raises very basic issues about the distribution of social responsibility between the private and public sectors.

While there is much that remains unknown about the best way to pay for, or even design, health benefits for retirees, there is a lot that we do know. From this knowledge, we can draw certain reasonable, if not always popular or easy, conclusions. The current system of retirement medical benefits is an artifact of the post-World War II era. Benefits were offered by the boom industries to supplement pension funds for the few years which retirees were expected to live after leaving the workforce at 65 or beyond. When Medicare was added to Social Security in 1965, the employment-based plans shifted their focus to a supplementary role.

Today, we have an outmoded system that is not equipped to cope with the success of medical technology that keeps people alive yet dependent upon high cost equipment and institutional care; nor with the success of expanded longevity which now has people in retirement for periods that can be as long as their entire period of employment; nor were these private sector plans expecting to have Congress dramatically reduce its commitment to Medicare by lowering benefits and shifting large segments of the program to employer plans. Finally, companies that are now in declining industries, such as steel, certainly did not design

their benefits with these economic problems in mind. Prefunding retiree health benefits has never been a public policy goal nor a private sector responsibility, therefore, we should not be surprised at its absence.

Notwithstanding the very real, human problems caused by benefit terminations, the fact remains that the vast majority of all retiree medical benefit plan changes over the last 10 years have been increases and improvements in plan coverage.

Following is a list of the benefit design changes instituted by many major employers that improve the medical plan for retirees. Not included are any changes which are strictly numerical increases in existing coverage.

- hospice
- second surgical opinion
- outpatient surgery
- prescription drugs; mail order drugs; generic drugs
- prevention programs
- outpatient mental health and substance abuse services
- pre-certification; pre-admission testing
- concurrent utilization review
- home health
- social workers
- case management
- HMOs
- PPOs, EPOs
- comparative price and quality referral services
- transplants; dialysis
- other non-Medicare covered services such as dental services, eyeglasses, or foot care

Not all retiree plans have all these features but many do and they are all part of what has been a trend toward better management and increased coverage. In addition, the importance of effectively communicating with retirees about plan changes affecting utilization is increasingly recognized by employers.

Congress and the courts need to realize that all of these improvements will be stopped if plan changes in general are forbidden. Indeed we are hearing more and more about companies who are limiting or completely terminating their contribution toward retiree health benefits for future retirees. We hope to quantify the extent of this activity in our upcoming survey; however, it points to the logical employer response of limiting liability in an uncertain environment.

Further, the public and private sectors are finally taking the need for catastrophic protection and long term care seriously. Several other Congressional proposals, the Bowen Advisory Committee, and substantial private sector analytical efforts are underway to fill these voids. If employer-provided retiree medical benefits are locked in place by law, you will be freezing in place the current over-emphasis on acute care and guaranteeing that intelligently orchestrated benefit expansions into long term and catastrophic care will not be forthcoming.

This is not presented as a defense for plan termination rather as a record of accomplishment that should not be jeopardized.

When presented as the case of a single retiree's medical needs, the cost of these benefits seems very small. However, when the estimates for aggregate employer liability for unfunded retiree medical benefits ranges from $98 billion to $2 trillion, it is not hard to see why the trend has shifted in the past two years from one of expansion to reduction in the benefits offered to currently active employees. This trend, which is in exactly the opposite direction Congress would like, is exacerbated by employer fear of FASB requirements to accrue the liability and of reports that the courts or Congress may require prefunding.

The prefunding issue is a classic example of how fast things are changing. In the 1970's and early 1980's, employers did not perceive much of a funding problem and thus only a few took advantage of the VEBA option. Congress then eliminated this option just as the issue was generating attention: Now, Congress

seems to want employers to prefund, more employers want to do so yet the incentives for using the VEBA option vehicle have neither been restored nor replaced with a better option.

Please understand that the problems caused by DEFRA are more than enough to cause the best employer intentions to be set aside. A case in point: RCA was one of the few companies which had been prefunding retiree medical benefits despite no requirement to do so. By 1985, they had a fund of approximately $180 million dollars. DEFRA then declares that RCA must pay a tax on the income earned by this fund. In the first year, this was $6 million which is 50% of their retiree health costs for the year. This is simply not a rational incentive to get more companies to prefund.

RCA also provides a good example of why prefunding is a real objective. Their current liability is only 1-2% of payroll. Over the next twenty years, in the absence of prefunding, that is projected to grow to over 20% due to demographic trends and the declining size of the active workforce. To maintain RCA stock as an attractive investment, in the face of pending FASB requirements, prefunding moves from an option to a necessity. Some other WBGH members are facing liabilities in excess of $1 billion dollars. Clearly there is a public interest in business-government cooperation to facilitate prefunding.

We also understand there is some employer concern about prefunding retiree health benefits through a pension plan under IRS Section 401(h). Two concerns have surfaced: 1) The 25% limit on contributions to a pension plan for retiree health -- a particular problem in light of other FASB required changes in pension plan funding and 2) Lack of a clear standard of practice with reference to how a company makes the transition from a pay-as-you-go funding method to an accrual-based method funded through a pension plan. We understand the FASB is investigating this latter issue and is hoping to develop an answer shortly.

No law requires any employer to provide retiree medical benefits. The focus of Congress is on those few companies which terminate benefits when the real issue is how to give more, if not all, employers an incentive to provide at least some measure of protection. The more restrictions placed on employer flexibility, the fewer companies will provide any benefit at all. A special problem has been created by the growth of a relatively new cohort: retirees who are not elderly. The result of two converging trends (early retirement and increased longevity), the group between 50 and 65 face a decade with no Medicare eligibility, and in the case of those whose private benefits are terminated, no private insurance that is affordable. This group represents more than 50% of all retirees with health benefits thus suggesting that a strategy for their protection will need to be different from that designed for those over 65. How benefits will be structured for people retired from one company but working part-time or in shared jobs, or under lease/contract arrangements for one or more other companies will be another challenge for business and government.

One of the most difficult aspects of the current situation is the element of surprise. Most retirees probably honestly believe that their benefits were guaranteed. This belief seems equally strong without regard to the actual language of the plan. Benefit managers, on the other hand, in WBGH surveys, report an equally strong belief that they can change plan design. Again, the strength of the belief is rarely in proportion to the actual plan language. In fact, nearly 40% of respondees to a December 1985 survey acknowledged they had never read the part of their own retirement plan pertaining to alteration or termination. Over the past year, one thing became clear, no new plans are being written without very explicit authority to alter or terminate. Less clear is how this will be communicated so that future retirees will really know the strengths and weaknesses of their plans.

CONCLUSIONS

One year ago, the staff of this distinguished Special Committee produced a report: Funding Post-Retirement Health Benefits. In it they concluded:

> "As important as retiree health benefits are, their future is increasingly in doubt. On the one hand, employers are finding the costs and potential liabilities for retiree health unpredictable and potentially devastating. Recent pressure for health care cost containment has forced employers to acknowledge the rapidly growing cost of covering retirees in group health plans. Per-worker costs of covering retirees have risen in older industries with an increase in the ratio of retirees to active workers. In addition, recent reductions in Medicare benefits and cost-shifting by hospitals have increased employers' costs."

This brief review leads us to a few conclusions:

1. Any retire health benefit law changes must consider the overall economic impact on US industry in world markets, and upon domestic employment.

2. The desire to protect against plan terminations should not become an excuse for prohibiting plan changes. Employers have to be able to change plans to meet market conditions for retirees just as they do for active workers.

3. Private employers and the government need to unite around a new investment strategy which will result in health care that is both affordable and appropriate for retirees. We know more than we give ourselves credit for:

a. prevention programs will work both to help the young experience healthy aging and to help the elderly ameliorate deterioration.

b. managed care, through negotiated provider arrangements, HMOs, etc., may limit choice but can also produce the savings that allow benefit plans, public or private, to be affordable. There is no reason to reduce quality in well designed managed care plans.

c. case management is in vogue because it works, and represents an understanding that the most cost-effective care is often available only when tailored to individual needs.

d. catastrophic illness insurance, is needed at affordable rates but cannot be for acute care only or it will skew the market to the most expensive and, frequently inappropriate care settings.

e. chronic, long term care is the essence of health benefits for retirees, especially those who are really elderly. We must finance the infrastructure that allows prudent purchasing of quality care in the setting most appropriate for each individual.

We appreciate the efforts of this Committee to thoughtfully address a tough social policy issue and look forward to working together with members and staff in the future.

PIERSON BALL & DOWD

OVERVIEW OF AN EMPLOYER'S RIGHT TO MODIFY HEALTH AND WELFARE BENEFITS FOR ACTIVE AND RETIRED EMPLOYEES

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The past decade has seen the cost of employer-provided health insurance and corresponding health insurance premiums escalate exponentially. In fact, since 1975 the cost of group health insurance has been the fastest-growing component of total labor costs. The burgeoning expense of health care has prompted many employers to revise the structure of their health plans and to work for fundamental changes in their health care delivery systems. Aside from these changes in benefit design, many companies have attempted to cope with the health care financing crisis by reducing, or terminating outright, the health benefits of its active employees or retirees.

This memorandum is intended to provide an overview of the legal principles governing an employer's right to reduce health benefits for active employees and retirees, with special emphasis on the applicability to such circumstances of the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. §§ 1001-1461 ("ERISA"), § 301 of the Labor Management Relations Act of 1947 ("LMRA"), 29 U.S.C. § 185, and relevant common law contract claims.

For the reasons explained below, we conclude that an employer may reduce the health benefits of its active non-union salaried and wage employees with a minimal risk of liability;

that an employer may reduce the health benefits of its active union wage employees prior to termination of the collective bargaining agreement only if the union consents and thereafter if the union consents or if the employer bargains in good faith to impasse and implements its final offer; and that because the legal principles governing a retiree's right to continued health benefits are in such a state of flux, resolution of dispute relating to the reduction of a retiree's health benefits is more a function of the forum, judge and facts of the case than the application of consistent legal principles. The prevailing view with respect to the reduction of retirees' health benefits, however, appears to be that such benefits are to be considered vested for life unless the employer clearly and unequivocally disclaims an intent that they so vest. Determination of an employer's intent turns on a factual analysis of the plan documents, as well as of extraneous evidence if the documents are deemed ambiguous.

I. LEGAL PRINCIPLES GOVERNING AN EMPLOYER'S RIGHT TO REDUCE HEALTH BENEFITS FOR RETIREES

A. Interpretation of the Health Benefit "Contract"

Resolution of the question of whether an employer has the right to reduce the health benefits of retirees is governed by federal law; potential state common law and statutory claims

have been preempted by the LMRA and ERISA. 1/ Retirees may seek judicial protection of their rights through enforcement of these two statutes. LMRA § 301 provides a statutory basis for suits for violation of contracts between an employer and a labor organization representing its employees. Such suits are governed by a specialized body of federal common law which the courts must fashion from the policy of our national labor laws.

ERISA provides several potential avenues to retirees seeking to enjoin or obtain damages for a reduction of health benefits. A reduction might be challenged as a breach of various fiduciary duties arguably imposed on the executives responsible for benefits. But the more troublesome question under ERISA is essentially the same as is posed under LMRA § 301 -- whether a reduction of benefits would constitute a breach of the terms of the plans. Such a breach would be actionable under ERISA § 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B). 2/ Because § 502(a)(1)(B) does not specify substantive criteria governing breach of contract claims, the courts have fashioned federal common law to guide their inquiry in this area, as well.

1/ See e.g., Allis-Chalmers Corp. v. Lueck, __ U.S. __, 105 S. Ct. 1904, 1911 (1985); Gilbert v. Burlington Industries, Inc., 765 F.2d 320, 328 (2d Cir. 1985). Most cases on this issue include retirees covered by a collectively bargained plan. The courts which have addressed the question in the non-union employee context generally have followed these cases without reservation, and we have addressed them together here.

2/ ERISA § 502(a)(1)(B) permits welfare plan participants to sue to enforce their benefit rights.

Essentially the same approaches have been taken by the courts under LMRA § 301 and ERISA § 502(a)(1)(B) in deciding cases involving collectively bargained plans as in deciding cases under § 502(a)(1)(B) involving non-union retirees. See Struble v. New Jersey Brewery Employment Welfare Trust Fund, 732 F.2d 325 (3d Cir. 1984). In both instances the courts generally have relied upon basic contract principles of construction to determine whether the parties intended to accord retirees the right to health or other welfare benefits unchanged for life (frequently called "contractual vesting"). It is this concept of contractual vesting that is the key to a determination whether benefits can be reduced.

If a court determines that a collectively bargained plan intended to provide retirees with lifetime health benefits, then the employer cannot reduce benefits below the level at which they vested, even if the union consents to the modification; the right is viewed as vesting personally in the retirees. Similarly, an employer cannot unilaterally reduce salaried retirees' vested benefits. 3/

The courts have analyzed the question of intent in various ways. However, the cases can fairly be divided into three

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3/ An employer has significantly greater leeway to modify the benefits of future retirees (i.e., currently active employees), because, as a general rule, these benefits will not have vested. There are, however, certain constraints on a company's authority to modify collectively bargained rights even if they are not vested for life. See discussion infra pp. 11-13.

general categories. In the first, the courts have recognized that health and other welfare benefits bear little resemblance to pension benefits (which under ERISA vest upon retirement) and, consequently, start with the inference that the employer did not intend retiree welfare benefits to vest for life. Under this theory, an employer is assumed to be free to modify retirees' benefits so long as it applies the rule prospectively to future claims for reimbursement filed by retirees. This in effect establishes an inference that welfare benefits do not vest in the strict sense of providing a nonforfeitable, lifelong right to a particular benefit level. See, e.g., Pierce v. NECA-IBEW Welfare Trust Fund, 485 F. Supp. 559 (E.D. Tenn. 1978), aff'd 620 F.2d 589 (6th Cir.), cert. denied, 449 U.S. 1015 (1980); International Ass'n of Bridge, Structural and Ornamental Iron Workers v. Douglas, 646 F.2d 1211 (7th Cir.), cert. denied, 454 U.S. 866 (1981).

In the second category, which includes the majority of cases, the courts have in essence started with the inference that retiree welfare benefits are intended to be vested at retirement. These courts therefore have concluded that the benefits were intended to be unchanged over the retirees' lifetime unless the employer expressly and clearly reserved the right to terminate or amend benefits, or otherwise evidenced an intent not to provide lifetime benefits. See, e.g., Bower v. Bunker Hill Co., 725 F.2d 1221 (9th Cir. 1984); International

Union, UAW v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983), cert. denied, __ U.S. __, 104 S. Ct. 1002 (1984).

Both of these first two approaches turn primarily on analysis of the plan document(s), the collective bargaining agreement(s), and other indicia of the parties' intent. In the third category, however, the documents are essentially irrelevant. Courts taking this approach (sometimes referred to as "status vesting") have found that where benefits are specified as accruing upon achievement of retirement status, the benefits are necessarily intended to vest for life. Under this theory, retiree benefits cannot be reduced below their level at retirement even if the employee has reserved the right to reduce or eliminate benefits.

The status vesting theory, however, has been utilized by only one court as the sole basis for imposing liability on an employer in the ERISA context and that court was subsequently reversed on appeal. See Hansen v. White Motor Corp., 7 EBC 1411 (6th Cir. 1986) rev'g in part and aff'g in part Hansen v. White Farm Equipment Co., 5 EBC 2130 (N.D. Ohio 1984). In that case, the United States Court of Appeals for the Sixth Circuit rejected the district court's imposition of an absolute rule effectively requiring mandatory vesting of retiree welfare benefits and concluded that, absent an agreement between the parties set out in the plan documents, "the legislature, rather than the courts, should determine whether mandatory vesting of retiree welfare benefits is appropriate." Id. at 1418. Under

LMRA § 301 and related contexts, the courts have sometimes applied the status vesting theory, sometimes applied an inference of vesting, and sometimes applied an inference of non-vesting. To add to the confusion, the issue frequently has been resolved without addressing apparently contradictory precedent, even when that precedent stemmed from the same court then addressing the issue.

There are strong policy considerations militating against status vesting of retiree health benefits, or even contractual vesting of such benefits, in the absence of a clear, unequivocal assumption of this obligation by the employer. General labor law principles and state insurance law, moreover, support an employer's right to amend a group insurance policy without the employees' consent, even if the right to amend has not been expressly reserved. On the other hand, it bears noting that in every federal labor law case in which the employer's right to reduce benefits has been upheld, the plan contained an express statement that the plan could be modified or that benefits were limited to a certain term (e.g., the duration of a collectively bargained agreement).

In sum, the legal principles governing a retiree's right to continued health benefits are in a state of flux. At the present time, however, a majority of the courts addressing the issue have concluded that an employer is essentially precluded

from reducing retirees' welfare benefits unless it affirmatively and unequivocally disclaims any obligation to provide lifetime welfare benefits.

B. Additional Considerations Applicable to Collectively-Bargained Plans

While the courts have tended to construe the terms of collectively bargained health plans the same as plans unilaterally provided to salaried employees/retirees, the union's involvement in the former does place additional restraints on an employer's ability to decrease wage retirees' benefits. These additional restraints, however, only come into play if the retirees' health benefits are not vested for life; as noted above, if the retirees' benefits are vested, an employer cannot reduce the benefits at any time even if the union consents. If the benefits are not vested for life, an employer's ability to modify benefits for existing retirees depends on whether the union agrees, and if not, whether the agreement has expired.

If an employer has provided health benefits for current retirees in the present collective bargaining agreement, a mid-term unilateral modification of these benefits would be actionable under LMRA § 301 as a breach of contract. Even if the union agrees to a mid-term modification, however, it is unclear whether such health benefits for current retirees can be reduced during the term of the collective bargaining agreement. The issue is whether their post-retirement health

benefits are contractually "vested" during the term of the current agreement. It could be argued that they are, because the retiree is required to do nothing further to be eligible for the benefits. But see Turner v. Local Union No. 302, International Brotherhood of Teamsters, 604 F.2d 219, 1225-1226 (9th Cir. 1979) (wage retirees' benefits not vested and reduction therefore permissible).

Once the collective bargaining agreement providing the benefit has expired, a company has far greater leeway to modify or eliminate post-retirement health benefits that are not vested for life. Indeed, the company may be able to unilaterally modify the benefits of current retirees at this time; because the matter is only a permissive subject of bargaining, it is unnecessary for the employer to obtain the union's consent to the change.

II. LEGAL PRINCIPLES GOVERNING AN EMPLOYER'S RIGHT TO REDUCE HEALTH BENEFITS FOR ACTIVE EMPLOYEES

A. Active Non-Union Employees

The recent line of cases holding that retirees have a vested right to lifetime benefits does not appear to have had an impact upon an employer's right to modify or terminate the health benefits provided currently active non-union employees, now or upon their retirement. Our research has uncovered no case in which active employees have been found to have a vested right to health benefits prior to their actual retirement. The

very theory underlying "status vesting," moreover, is that these rights vest once the employee has assumed the "status" of a retiree. For employees who have yet to retire, therefore, it appears that an employer will be able to eliminate the entitlement to current health benefits and to retirement health benefits.

It nonetheless is not out of the realm of possibility that a court could find an employer liable for a reduction in the future retirement benefits of active employees -- especially for active employees who are near retirement. Such liability could be predicated on a number of theories, which find support in the case law and relevant treatises. First, one court has held, in the pre-ERISA collective bargaining context, that the employer and union could not amend a pension plan so as to deprive employees of their contractual right to a share of the assets remaining in the fund upon the plan's termination. Hauser v. Farwell, Ozmen, Kirk & Co., 299 F. Supp. 387 (D. Minn. 1969). 5/ While that case is in our view poorly reasoned and is contrary to the thrust of a more recent line of cases holding that an employer can amend a plan, in anticipation of its termination, so as to provide itself with

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5/ The fact the amendment was made a mere two weeks prior to the plan's termination appeared to be the motivating force behind the court's decision. See 299 F. Supp. at 393.

the reversionary interest in plan assets, 6/ a court could conceivably follow Hauser and hold that an employer may not reduce future retirement health benefits promised to active employees.

Second, a court could invalidate such a reduction on the basis that it is inconsistent with the unilateral contract theory -- that a binding contract is formed when an employee provides services in exchange for the promise of future benefits. See 1A, Corbin on Contracts § 153 pp. 19-20 (1963); Restatement (Second) of Contracts § 45. In reliance on these principles the Fourth Circuit found that even pre-ERISA, there was no reason to differentiate between the entitlement of an active employee who had fulfilled the requisite number of years of service and a retired employer who had completed the further condition of having actually retired. Rochester Corp. v. Rochester, 450 F.2d 118, 120 (4th Cir. 1971). By parallel reasoning, a court could conclude that an active employee's entitlement to retirement health insurance vests after a certain period of "substantial service."

Finally, a court could impose liability based on equitable theories such as promissory estoppel. While the risks that

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6/ See Washington-Baltimore Newpaper Guild Local 35 v. Washington Star Co., 555 F. Supp. 254 (D.D.C. 1983), aff'd without opinion, 729 F.2d 863 (D.C. Cir. 1984); In re C.O. Moyer Co. Trust Fund, 441 F. Supp. 1128 (E.D. Pa. 1977), aff'd without opinion, 582 F.2d 1273 (3d Cir. 1978); International Union, UAW v. Dyneer Corp., 747 F.2d 335 (6th Cir. 1984).

these theories could be adopted is present, these concepts are not well established in the law.

B. Active Union Employees

As is the case with respect to current retirees, an employer's ability to change health benefits for future union retirees (current union employees) depends on whether the collective bargaining agreement providing for such benefits has expired, and on whether the union agrees to the modification.

During the term of a collective bargaining agreement, an employer can make changes concerning mandatory subjects of bargaining, such as health benefits provided to current employees, 7/ without committing an unfair labor practice only if the union consents to the modification. E.g., NLRB v. Katz, 369 U.S. 736 (1962). Similarly, because the future retirement benefits of active workers are a mandatory subject of bargaining, a mid-term unilaterial modification of these benefits would constitute an unfair labor practice. Titmus Optical Co., 205 NLRB No. 159 (1973). A unilateral modification of current or future retirement benefits of active employees would also be actionable under LMRA § 301.

7/ Health benefits for current employees are a mandatory subject of bargaining. Allied Chemical & Alkali Workers Local 1 v. Pittsburg Plate Glass Co., 404 U.S. 107, 159 (1971).

After the agreement has expired, an employer would still be required to negotiate any change in these benefits with the union. 8/ However, if the employer bargains in good faith to impasse on this issue, it may then unilaterally modify or terminate the current or future retirement benefits of active employees in accordance with its final offer to the union. See, e.g., American Distributing Co. v. NLRB, 715 F.2d 446 (9th Cir. 1983), cert. denied, __ U.S. __, 104 S. Ct. 2170 (1984).

III. CONCLUSION

The rising cost of health care and the corresponding increase in health insurance premiums has lifted the issue of the legality of welfare benefits reduction towards the top of the list of problems facing employers today. Until the issue is resolved definitively, employers are going to be reluctant to address the health care cost containment crisis on an across-the-board basis.

8/ The prohibition against unilateral changes affecting mandatory subjects of bargaining extends past the expiration of a collective bargaining agreement. E.g., American Distributing Co. v. NLRB, 715 F.2d 446 (9th Cir. 1983), cert. denied, __ U.S. ____, 104 S. Ct. 2170 (1984).

Senator WARNER. Mr. Chairman, might I ask a question?

Chairman HEINZ. By all means.

Senator WARNER. I have to return to the floor on the military authorization bill.

I have known Mr. Ryan for many years. Would you provide for the record now, briefly, your career in the Department of Labor, and then I will propound the question.

Mr. RYAN. Yes, Senator. Senator Heinz, I was the Solicitor of Labor during the initial period of the Reagan administration from 1981 to 1983, and since that time I have also served on the ERISA Advisory Council. We had a working group in fact on health benefit issues and have addressed some of these questions, I must say quite broadly, though, and not with the same specificity with which your staff has looked at it.

Senator WARNER. That was the nature of my question. During the course of your tenure in the Department of Labor, or even today, because I am sure you are familiar with the Department's activities, is there an area within the Department that is studying this issue?

Mr. RYAN. At present, Senator Warner, the Department of Labor has just completed a study which was required by DEFRA on funding of health benefits. I know they are waiting eagerly for a similar report from the Treasury which will discuss funding. It is my understanding that the administration will engage in somewhat of an in-depth study of their position on the issues that, quite frankly, have been raised on page 18 of the committee's report.

Senator WARNER. Could you suggest to this committee what the Congress might do by way of encouraging, inducing, or directing the Secretary of Labor to do some research in this area?

Mr. RYAN. Senator, I guess my feeling is——

Senator WARNER. You mentioned ERISA, which is another area in which there was dire need at one time, and now that seems to be alleviating some of the hardships.

Mr. RYAN [continuing]. The Department of Labor—and I think this is probably true of most of the Government agencies, save maybe HHS—has viewed the health benefit issues as secondary to the pension benefit issues. I think they are now finally coming to the realization that the health benefits, especially the health benefit contingent liabilities, are as big an issue/problem as unfunded pension liabilities. My sense is, knowing Secretary Brock, that they will be on top of this issue.

Senator WARNER. Well, I certainly concur in your observation that this issue is parallel with pension in terms of significance and importance. All too often an individual is faced with a crisis under this one before they would be faced with a crisis under the pension problem.

Again, do you have any suggestions to this committee as to what we might do by way of directing through legislation the Secretary of Labor to perform certain research or to coordinate with other Government agencies, because it does spill over into other departments, this responsibility?

Mr. RYAN. The only recommendation I would have, Senator, is that the executive branch is dealing with somewhat of a half-a-loaf now. They are waiting for the other half from the Treasury.

Groups such as the Washington Business Group on Health would like to see the Treasury's response to the mandated DEFRA funding study. That would help close the loop here because at least my view is that it will be very difficult for Congress and the executive branch to address these issues, especially when they involve funding questions, without input from the Treasury.

Senator WARNER. Thank you.

Thank you, Mr. Chairman.

Chairman HEINZ. Thank you very much, Senator Warner.

Mr. Baird?

STATEMENT OF DOUGLAS G. BAIRD, PROFESSOR OF LAW, UNIVERSITY OF CHICAGO LAW SCHOOL, CHICAGO, IL

Mr. BAIRD. Thank you, Senator.

I am a professor of law at the University of Chicago, and I have been asked to address the narrow question of the current status under existing law of retiree health benefits and bankruptcy.

This issue raises two distinct questions. The first question is where do retiree health benefits stand vis-a-vis other obligations of a firm that has filed a bankruptcy petition. And this question is important. If a firm is in bankruptcy, typically, it is insolvent. If a firm is insolvent, that means by definition, it will not keep all of its obligations. The status of retiree health benefits vis-a-vis other obligations becomes critical because the higher its status, the more likely it is the firm will meet these obligations.

The second question arises only if these retiree health benefits will be paid. This is the question of when retirees will be paid. This is also important because the typical rule in bankruptcy reorganizations is that those to whom a firm owes obligations—obligations that arose before the filing of the petition—are not paid anything until the bankruptcy proceeding is over. In many cases a bankruptcy proceeding lasts several years.

Now let me address the first question.

Take the case of a firm that liquidates, a firm that goes out of business and shuts up operations. This is the case for all firms that are in chapter 7 and for most of the firms in chapter 11. (Many of the firms enter chapter 11 with the hope of surviving as going concerns, but do not.) And this would also include divisions of corporations that are separately incorporated that go out of business. As best I can tell, if the firm liquidates, retiree health benefits have the status of unsecured claims. To the extent that retiree health benefits, in other words, are deferred compensation, to the extent they are like unpaid wages, then it is clear they have the status of unsecured claims. Unsecured claims in a bankruptcy liquidation are paid less than 100 cents on the dollar. Typically, they are paid a lot less than 100 cents on the dollar.

Now, if these rights were not vested, or if the right arose only out of an ongoing collective bargaining agreement, and, as I said, the firm liquidated, then these retiree health benefits would be treated even worse. In other words, a retiree would not even get 20 or 30 cents on the dollar.

The cause of for this state of affairs, however, is not bankruptcy law proper. Bankruptcy law is primarily a Federal procedure for

sorting out the affairs of an insolvent corporation. The basic rule of bankruptcy law is that it takes rights as they exist outside of bankruptcy. Retiree health benefits fare poorly in bankruptcy because of the status of these rights outside of bankruptcy. In other words, if Congress decides that those promised health benefits in the *LTV* case, for example, should in future cases be treated better in bankruptcy, the solution is not to change the bankruptcy laws, but rather to change the rights of these retirees under nonbankruptcy law. Bankruptcy law will mirror nonbankruptcy law. If these rights are vested, funded and protected outside of bankruptcy, they will be protected inside of bankruptcy as well.

I would caution against trying to solve the problem by creating a special status for retiree health benefits in bankruptcy. I would caution against this for essentially two reasons. First, if you give retirees special benefits in bankruptcy, you are only curing half the problem. Most of the firms in this country that fail never file bankruptcy petitions. Hence, those who are promised health benefits by corporations that fail but do not file bankruptcy petitions will not be helped at all if help is given only to those who are fortunate enough to work for firms that fail that file bankruptcy petitions.

Second, if you create a special set of rights in bankruptcy but not elsewhere, you create a perverse set of incentives to keep firms from organizing their affairs inside of bankruptcy. You may end up with situations where retirees lose both because the firm fails outside of bankruptcy, but also because the benefits of bankruptcy are lost. A disincentive to go into bankruptcy is created by a special right that exists in bankruptcy but not elsewhere.

Turning briefly to the second question, this is an area in which I think you may find the existing bankruptcy laws defective. It is all well and good for a large financial institution to be told it has to wait until the end of a bankruptcy reorganization. Those who crafted the Bankruptcy Code may very well have envisioned the typical creditor not as an unpaid worker or a retiree who is promised health benefits, but a large bank. As long as the time value of its money is taken into account, a bank does not care whether it is paid now or 3 years from now. But an employee or someone else who does not have other resources may be someone who should not have to wait until the end of the bankruptcy proceeding.

Hence, it may very well be the case that Congress should consider passing some kind of amendment to the Bankruptcy Code that would allow retirees who will be paid eventually to be paid sooner rather than later. A problem, of course, with this second proposal is that you have to be able to figure out whether or not they will be able to be paid eventually in order to decide whether or not to pay them immediately.

The whole situation is very unfortunate, but I am afraid the situation does not in fact arise because of bankruptcy law. Bankruptcy deals with unfortunate situations, but does not cause them.

Thank you.

Chairman HEINZ. Very well. Thank you very much, Mr. Baird.

[The prepared statement of Mr. Baird follows:]

STATEMENT OF DOUGLAS G. BAIRD

Professor of Law, The University of Chicago

My name is Douglas Baird. I am a professor of law at the University of Chicago Law School where my fields are bankruptcy and commercial law. I have no clients and am speaking only as an expert on bankruptcy law. Today I have been asked to talk about the effect our bankruptcy law has on the promises a corporation has made to its retirees concerning health and medical benefits and the like. I shall not discuss directly the effect of bankruptcy law on employee pension benefit plans under ERISA.

I want to begin with some observations about the general principles of bankruptcy law and then explain how these might apply to benefits for retirees. There are three basic questions that are raised: (1) the nature of the rights of the retirees outside of bankruptcy; (2) the priority of the obligations the firm owes the retirees relative to the obligations it owes others; and (3) whether, if the retirees will be paid, payments should be postponed during the pendency of the bankruptcy proceeding.

Insolvent corporations cannot meet all their obligations. Corporations have limited liability under state law. As long as a firm is allowed to do business in the corporate form, some of those to whom the firm owes money will be disappointed when the firm fails and then dissolves or restructures its debts. This is true regardless of whether the firm files a bankruptcy petition or even whether bankruptcy law exists.

One can (and I think one should) emphatically embrace the idea that bankruptcy law should not allow a corporation to evade promises it has made to its workers, suppliers, banks, or anyone else. But if a firm has made too many promises, it will not be able to live up to all of them in full. There is nothing that bankruptcy law can do to change this. That is, indeed, the meaning of insolvency.

Even if a corporation will not meet all of its obligations, however, two important issues remain. First, one has to decide which obligations a firm will meet and which it will not. Second, one has to decide what will be done with the assets of the corporation that has failed, a decision that typically involves the question of whether to continue the firm as a going concern. These questions often arise in the context of a reorganization under Chapter 11 of the Bankruptcy Code, but the legal principles are the same if there is a liquidation under Chapter 7. I shall therefore begin with the simpler case of an insolvent firm that is liquidating.

I shall assume that Firm promised its workers that, if they worked for it for a given period of time, Firm would pay for their health care after they stopped working. I shall also assume that Firm has no right to terminate its obligation unilaterally.[1] The promises that the existing retirees have a face value of $1

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1. Some corporations have asserted that promises that they have made to retirees are ones they may terminate unilaterally or ones that cease when a collective bargaining agreement is over whether in bankruptcy or not. E.g.,

million. (I.e., this is the amount of money an insurer would require to assume the obligations that Firm has made and pay them in full.) Assume further that Firm has borrowed $1 million from Finance Company and given Finance Company a security interest in all of its assets. Finance Company has properly perfected its security interests under applicable law. Firm has also borrowed $1 million from Bank on an unsecured basis. Firm's assets can be sold for $1.5 million and everyone agrees that Firm's assets should be sold piecemeal. Firm is not viable as a going concern.

In the case I have posited, there are $3 million in claims and only $1.5 million in assets. The shareholders of Firm will, of course, receive nothing. Because Firm is insolvent, it is unable to pay all of its claimants in full. The issue, then, is how to divide the $1.5 million that is available among Bank, Finance Company and the retirees. The claims of these three amount to $3 million.

The relative rights of these three creditors under nonbankruptcy law is clear. Finance Company -- the secured creditor -- takes priority over Bank and the retirees. Bank and the retirees are on a par with one another. They are both general creditors. Neither one has a priority over the other. This may or may not be a good ordering. Congress may or may not want to change it. I think, however, I accurately summarize current law. Firm has no right to terminate its promise to its retirees, but it has no right to refuse to repay Bank either. Existing law treats the promises to the retirees and the promise to Bank identically.

Bankruptcy law, to a great extent, takes nonbankruptcy entitlements as it finds them. Under existing bankruptcy law, Finance Company would recover its $1 million and Bank and the retirees probably would divide the $500,000 that remains. There are a number of complications that I shall consider, but before I get to them, this example and these aspects of existing law raise the question before you in the clearest form. This result may not be the one that you want in bankruptcy -- one in which retired workers who were promised medical care receive only a quarter of what they were promised.

There are several ways of approaching this question. The first and most important observation I would urge upon you is that the result in bankruptcy (payment of only 25 cents on the dollar) is not a feature of bankruptcy law per se. It arises only because bankruptcy law tracks nonbankruptcy law. If you want

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International Union, United Automobile, Aerospace, and Agricultural Implement Workers of America and Local 134 v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983); In re White Farm Equipment Co., 788 F.2d 1186 (6th Cir. 1986). Whether corporations have such a right turns on the interpretation of the relevant contract or collective bargaining agreement. Congress might consider whether the ability of firms to terminate such plans should be limited regardless of what the contract provides. The issue involves the question of the extent to which the protections ERISA provides for employee pension benefit plans should be extended to other employee benefit plans.

As I suggest below, the amount of protection retirees receive in bankruptcy turns in large measure on the benefits they are entitled to outside of bankruptcy. If a corporation is free to change employee benefits outside of bankruptcy, it cannot be an abuse of bankruptcy per se if the corporation tries to make such changes inside of bankruptcy. The defect would lie in the ability to terminate generally.

to ensure that retirees' medical benefits have a privileged status vis a vis other claims against a corporation, you should change the relevant nonbankruptcy law. Please bear in mind that if you change relevant nonbankruptcy law, you will also change the result in bankruptcy. Bankruptcy law generally mirrors nonbankruptcy law.

Most firms that fail never file a bankruptcy petition. If you want to make sure that retirees receive the medical care they were promised, you should make sure you include all retirees. It makes no sense to protect just those retirees of failed firms that filed bankruptcy petitions. These firms, as I noted before, are only a minority of those firms that fail.

Moreover, if you give retirees benefits inside of bankruptcy, but not outside, you compound the problem. Firms that would otherwise reorganize their affairs inside of bankruptcy will be dissuaded from doing so. Everyone may be worse off, because the restructuring that takes place outside of bankruptcy may be more costly. It could, for example, lead to a piecemeal liquidation of a firm that should stay in business. A piecemeal liquidation may bring an unnecessary loss of jobs.

There are any number of ways of protecting the medical benefits of retirees. The simplest is one that provides that whenever a corporation promises medical benefits to its retirees, the retirees have, upon a liquidation or reorganization of the firm, a first lien on all the assets of the firm.[2] There are, of course, variations on this. You might, for example, want to subordinate the lien to the claims of secured creditors, but put it ahead of the claims of the general creditors.

I do not want to dwell on the wisdom of giving these kinds of benefits to retirees. Let me note, however, that there are at least two kinds of side effects to granting protections to retirees: (1) Imposing requirements on the provision of medical benefits may make firms less likely to offer them in the first instance; and (2) giving retirees special rights to share in a failed firm's assets necessarily comes at someone else's expense. If the party that gets less is a large financial institution, it can cover the added risk by charging higher interest rates and spreading the risk among its many debtors. But bear in mind that a corporation owes obligations to many besides large financial institutions. The federal government as tax collector is typically one of the largest creditors of an insolvent firm. Pension obligations to existing workers may also loom large. If one group, such as retirees, are favored, others, such as tort victims, existing workers, or suppliers, are necessarily disfavored. Trade-offs must be made.

So far I have assumed that the right of retirees to health benefits is a right that they enjoy simply by virtue of their own efforts in the past. The obligation is nothing more than a liability of the firm. These rights are no different from the promise of the firm that defers payment of salary until a subsequent year. The right against the firm is independent of whether the firm continues to exist because the right arose out of services that the worker has already performed.

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2. In order to ensure that this lien is respected in bankruptcy, an appropriate amendment to § 545 of the Bankruptcy Code would have to be made because of the general limit it places on "statutory liens."

Moreover, the obligation of the firm is not linked to any asset of the firm. If the promises are all for past services, there are no reciprocal obligations still owing to the firm in exchange for the promise of health and medical benefits.

But promises to retirees may in fact not be naked liabilities. In a particular case, retiree benefits may be linked to obligations that existing workers owe to the firm. The existing workers, as part of their collective bargaining agreement, might have required that health benefits be provided to retirees as a condition of their working for the firm. To the extent that retiree health benefits arise only because of promises the firm makes to existing workers for the work that they are presently doing, they take on a different character.

If the firm were to liquidate, the retirees would be worse off than if the promises to them were simple liabilities. Their benefits arise out of the employment contract with existing employees. They are the third-party beneficiaries of the contract between the firm and the existing employees. Their right against the firm's assets when the firm no longer operates and the existing employees work elsewhere may be quite small. Even if the firm were to stay in operation as a going concern, the retirees may be worse off. Their benefits are contingent upon the existing workers bargaining for them and this they may not do. The ability of the firm to compromise the interests of the retirees would not be a function of bankruptcy law, but rather a function of the firm's nonbankruptcy obligation.

Nevertheless, there is a respect in which retirees might be better off if their benefits arose out of the contract between the firm and existing employees than if it were a simple liability. A firm in bankruptcy has to play by the same rules as everyone else. It cannot expect its employees to continue to work for them unless they are paid what it promised. The firm has a right to the services of its employees only if it lives up to its end of the bargain. Section 1113 of the Bankruptcy Code gives a firm in bankruptcy a procedure that it must follow if it wants to renegotiate a collective bargaining agreement. The retirees, of course, could have their interests compromised during such a renegotiation, but until this renegotiation takes place, the firm cannot unilaterally alter the terms of the collective bargaining agreement.

Let me summarize the effects that current bankruptcy law has on benefits for retirees. If it is a mixed asset and liability, that is, if the firm gives the retirees benefits in return for the services of its current employees, the firm must honor its agreement unless it follows the procedures set down in the Bankruptcy Code. Once these procedures are followed, however, the retirees may be left with little or nothing. On the other hand, if the obligation to the workers is a simple liability -- because the workers provided their services to the firm in the past and now owe it nothing more, the firm will stop providing benefits when it files a bankruptcy petition. Payment will be suspended until the reorganization is over. The filing of a bankruptcy petition automatically stays the right of any creditor to be paid. The idea is that unless all the creditors stop their efforts to be repaid, there will be a destructive race to the firm's assets that will leave everyone worse off. If every creditor tries to grab assets, firms that should survive as going concerns might not be able to. Because a bankruptcy proceeding can take a long time, creditors in general must wait.

This feature of bankruptcy law, dealing not with the priority of retirees (this is not a bankruptcy question), but with the timing of the payout, is one that

you might consider changing. Creditors may not be equally well situated to wait. A financial institution is indifferent to getting paid now rather than a year from now, as long as it is paid for the time value of its loan. Workers may not be similarly indifferent because they may not be able to borrow against their right to payment in the future. The Bankruptcy Code could be amended to provide that some (such as workers) who will be paid at the end of a Chapter 11 proceeding be paid at the start. Such an amendment would also make the Bankruptcy Code conform to current practice, in which workers sometimes are paid prepetition wages. Early payment could be left to the discretion of the bankruptcy judge. It might also be allowed only after notice was given to the other creditors and a hearing were held.

A difficulty in implementing such a reform is that payments should be made at the start of the proceeding only if they would be made later. If the workers will not receive 100 cents on the dollar at the end of the bankruptcy case, they should not receive 100 cents at the start. In order to ensure parity between early payments and payments at the end of the case, one would also need to take into account the time value of money. In some cases, a firm may have so much in the way of secured obligations that nothing will remain for anyone else.

There is another provision of the Bankruptcy Code that I should mention. Section 507(a)(4) gives a priority to prepetition claims that are contributions to an employee benefit plan. This section can do little for retirees. The exception applies only for services rendered within the six months before the filing of the petition and priority is limited to $2,000 per employee. Moreover, unpaid wages and unpaid contributions to pension plans are also counted toward the same $2,000 cap.

One could, of course, amend § 507 so that it includes retiree medical benefits explicitly. One could raise the $2,000 cap and remove the time limit. I should point out, however, that such an approach to the problem has two serious weaknesses. First, as I noted before, it uses bankruptcy law to try to solve what is not in fact a bankruptcy problem. If retirees deserve protection, they should be protected regardless of whether the failed firm uses bankruptcy. Second, giving retirees priority does not take care of the problem of the timing of the payout. Getting priority under § 507 does not give retirees a right to get paid before the end of the bankruptcy case and a large bankruptcy reorganization can last several years.

Let me end on the general question of whether firms can use bankruptcy (in particular Chapter 11) to evade their obligations. One must remember what one means by "the firm." A corporation is a juridical being created under state law. There is a particular collection of assets. These assets may be used for making building materials, steel or automobiles. But no one should object to a procedure that ensures that the assets continue to be used in the same way. No one benefits if a firm is broken up piecemeal when the assets are worth more if they are kept together.

The owners of the corporation, those whose rights should take a back seat to all to whom the firm owes obligations, are the shareholders. But bankruptcy cannot be used by shareholders to get assets that should go to those who have claims against the firm. A corporation in Chapter 7 does not even get a discharge and nonbankruptcy law prevents shareholders from receiving dividends while the firm is insolvent. The rule in Chapter 11 is that, in the absence of a contrary

agreement, all creditors must be paid in full before the shareholders receive anything.

Manville is a case in point. The firm no longer sells asbestos. All agree that the firm should continue as a going concern. Whether the existing managers should remain is a decision for those who hold an equity interest in the firm. If the latest plan of reorganization is any measure, the managers of Manville were mistaken if they thought they could use Chapter 11 to protect either their jobs or the investment of the firm's shareholders. The old holders of common stock of Manville will receive only about 5% of the reorganized firm. The trust that will pay for the claims of the victims of asbestosis will receive, in addition to more than half a billion dollar in cash, up to 80% of the common stock of the reorganized firm. The victims of asbestosis, in short, will get control of the whole company. If they don't like the managers of the firm, they can get rid of them. This is exactly the way it should be. What bankruptcy is able to do is ensure that payment to the victims of asbestosis did not destroy the value of Manville as a going concern. Everyone, including the victims as well as the employees of Manville, are better off if the rights of those to whom the firm owes obligations can be sorted out without affecting the firm as a going concern.

Bankruptcy can be abused only if substantive rights change in bankruptcy. As long as people are treated the same in bankruptcy as outside, no one will have an incentive to enter into bankruptcy except for the right reason, which is the need to sort out rights to the firm in an orderly way that does not interfere with the optimum use of the firm's assets.[3]

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3. Any bankruptcy legislation that Congress passes must be directed to more than the affairs of a single debtor. The bankruptcy clause of the Constitution limits Congress to enacting "uniform laws on the subject of bankruptcies." (emphasis added) The Supreme Court has held that this requirement prohibits Congress from enacting a bankruptcy law that, by definition, applies only to one debtor: "To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors. A bankruptcy law . . . confined . . . to the affairs of one named debtor can hardly be considered uniform." Railway Labor Executives' Association v. Gibbons, 455 U.S. 457 (1982).

Chairman HEINZ. Well, you have all given us plenty of food for thought and some differences of opinion.

Starting with Mr. Dudovitz, let me ask the following. Mrs. Grimaldi said in response to a question to Senator Dodd that now that the Teledyne Co. has agreed to pay benefits, she is protected forever—is that true?

Mr. DUDOVITZ. Well, I also think she said it was in terms of some court settlement. Maybe she is protected because of the court settlement, but she would not necessarily be protected. That is, the issue really will be what her husband's contractual rights were with Teledyne, and how specifically the plans or the contract were worded. Did they specifically say that Teledyne had the right to reduce or terminate the benefits.

Chairman HEINZ. Let me turn to our bankruptcy expert, Mr. Baird. Suppose Teledyne goes into chapter 7 tomorrow. Suppose they just have a stunning liability judgment against them; some judge in Texas says they have got to post an $11.5 billion bond, and they say, "Well, the only way we can do this is to liquidate." What happens to Mrs. Grimaldi? Is she still protected? Does she have a special status as a prior-secured creditor?

Mr. BAIRD. Assuming there has been no special funding arrangement—and I obviously do not know what the details are——

Chairman HEINZ. Let us assume there is no special funding arrangement.

Mr. BAIRD. If there is no special funding arrangement, she will have an unsecured claim against Teledyne.

Chairman HEINZ. So even this court settlement, approved by the court, if there is no funding mechanism, if the company really gets into financial difficulty, it is not worth the paper it is written on.

Mr. BAIRD. It may be worth 20 cents on the dollar.

Chairman HEINZ. Yes. Or more, or less.

Mr. BAIRD. Or less, yes.

Chairman HEINZ. OK. Now, let me ask Mr. Goldbeck, you said that most retirees do not have the kind of health benefits we have been talking about today. There are 7 million of them who do. How many retirees are there who are not Medicare-eligible in your category?

Mr. GOLDBECK. Well, when you consider that the vast majority of American workers work for small businesses, businesses of 100——

Chairman HEINZ. I just want the number.

Mr. GOLDBECK. I do not have a finite number, but I can give you a way to estimate.

Chairman HEINZ. Well, no offense. I have had a good occasion to work with you, but you are smart enough to know that you should not make a statement to a committee of Congress without being able to quantify it. You cannot say, "Well, there are a lot more of these guys than those guys," and not put some parameters on it.

Mr. GOLDBECK. I would be more than happy to get a number for you.

Chairman HEINZ. We have estimated carefully there are 2.6 million of early retirees who are not covered by Medicare, but who have been promised and who are receiving, I guess, for the most part health benefits.

You made a statement, but what you are saying is you do not really know how many people are in that category.

Mr. GOLDBECK. I am not retracting my statement at all, and I will be delighted to attempt to get a finite number.

Chairman HEINZ. No, but you are not backing it up, either.

Mr. GOLDBECK. But I can assure you that if the vast majority of workers are retiring from firms that do not have those benefits——

Chairman HEINZ. I do not want to waste time on this issue, but if you are going to make a statement I would like you to quantify it for me.

Mr. GOLDBECK. I would be happy to.

Chairman HEINZ. So, try and do that later.

Mr. GOLDBECK. I would be pleased to.

[Subsequent to the hearing, the following answers were submitted by Mr. Goldbeck in response to questions from Senator Heinz:]

Q. "How many retirees are there in the United States who are not medicare eligible, and how many of that number are currently covered by employer-sponsored health plans?

The first part of this question is difficult to answer. The question asks how many retirees are under age 65 who do not receive disability payments through medicare. The main barrier to a quick answer to this question stems from the problem of defining "retired."

A person may be a retired pensioner from one company and be self-employed or a full or part-time employee at another firm. In addition, a person may be retired from a company but without pension eligibility. To complicate this even further, much in the same way that pension eligibility is often confused with retirement, retirement is often mistaken for absence of labor force participation. The fact that a person is not working does not mean that the person is retired: the person may never have worked, never worked regularly enough to be considered "retired", be "permanently " laid-off, or may, as is the case with many older women, just be entering the ranks of job seekers.

A narrow definition can help here. Estimates by the Employee Benefit Research Institute (EBRI) indicate that there are 5 to 6 million retirees between the ages of 55 and 64 who are recipients of either a government pension, a private pension or are social security eligible (The estimates are based on data from the Social Security Administration report The Income of the Population 55 and Older, SS-11871). It is further estimated that between 15 and 30 percent of this population are labor force participants, with the younger age categories more likely to be working. If defining an early retiree narrowly, as an adult aged 55 to 64 who receives a pension and does not participate in the labor force, the number is somewhere between 4 and 5 million.

It is difficult to estimate, however, the number of retirees in this category that are receiving coverage through medicare. In 1983 there were over 1½ million individuals aged 54-65 receiving medicare payments for hospital and supplementary medical insurance, as well as for end stage renal disease (Social Security Bulletin, Annual Statistical Supplement, 1984-85, 13-1170).

The second part of this question asks how many early retirees are covered by employer-sponsored health plans. The most recent estimate of this amount was presented in the May 1986 Labor Department Report entitled Employer-Sponsored Retiree Health Insurance. The report states that in 1983 "an estimated 2.6 million retired persons under age 65 were covered by health insurance provided by private sector employer[s]." Of this figure, 1.6 million were retired workers, 1.0 million were covered dependents. The derivation of these estimates are based on the 1983 Survey of Income and Program Participation (SIPP), conducted by the Bureau of the Census.

The Labor Department Study used the SIPP study to determine that

there are 3 million retirees (not including spouses or other dependents) over the age of 65 receiving employer-sponsored health care benefits, and 1.6 million retirees under age 65 receiving those benefits. Thus, based on the Labor Department figures, the ratio of post-65 retirees to early retirees is 65 : 35.

In our Post-Retirement Medical Benefits Survey Report of June 1985, we analyzed the health care coverage provided to retirees by our member companies. A subgroup of 70 of those employers provided data on the numbers of retirees over and under age 65. The collective ratio of over age 65 retirees to under age 65 retirees in the WBGH report was 66 to 34 (raw data: 526,959 : 275,605, n=70). Since 98% of our members provided health benefits to early retirees and 95% provided benefits to retirees over age 65, the aggregate numbers of those 70 companies providing health benefits are 500,611 (+65) and 270,092 (-65). The new ratio is thus exactly as given by the Labor Department study (65.0 to 35.0).

The congruence of survey results lends some credence to the validity of the two separate findings as correct representational samples of the proportions of age groups covered. In addition, government researchers are continuing to use the data generated by the SIPP survey as the basis for benefit analysis. In a report to be given in an October 1986 conference at the Leonard Davis Institiute, researchers from the National Center for Health Services Research will be citing substantially the same data used by the Labor Department. The report is entitled Private Employers: Silent Partners in Financing Health Care for the Elderly, by Pamela Farley Short and Ellen Monheit.

The outstanding question, however, is whether the figures generated through the SIPP survey correctly interpret the actual number of early retirees receiving health care benefits.

Skepticism may be justified here. The aggregate number of retirees under 65 at the following companies: G.M., Chrysler, Ford, AT+T and the divested Bells, amounts to approximately 320,000, or 20% of the 1.6 million, with GM alone accounting for over 91,000 or 6% of the Labor Department figures. Since GM provides benefits for 1% of the insured population nationwide, it seems unlikely that the company would provide the degree of coverage required by the Labor Department statistics.

A problem is furthered indicated through an analysis of the aggregate costs at GM for retiree health coverage and Labor statistics. National retiree health expenditures were estimated in '85 to be $4.6 Billion dollars while costs for GM alone were over $800 million. This would put GM's share of the retiree health care bill at nearly 20% of the national total, a figure that seems much too high.

The upshot of this is that there are probably more than 1.6 early retirees receiving employer-sponsored health care benefits. Exactly how many, we don't know.

The second question from Senator Heinz concerns the extent to which companies continue to operate while closing down individual plants and eliminating benefits therein.

There are at least seven ways that companies have reduced or eliminated health benefits for their retirees:

1) through permanent plant closures, of which there are 20 or more instances.

2) the sale of a business.

3) plant relocation, preceded by local plant closure.

4) reduction or termination of benefits during work stoppage following expiration of labor contract.

5) concession bargaining.

6) implementation of cost containment program.

7) bankruptcy.

All of these situations have different legal status. In addition, each act may vary in its legality according to the category of worker affected (wage, salaried, unionized, nonunionized).

There is no simple answer nor clear legal precedent to the question of the employer's obligation to retirees in the varied instances cited above.

Chairman HEINZ. Frankly, your statement may or may not be true. I understand the logic that you have got, but there are a lot of things that are logical that are not necessarily right.

Let me go to the second one. Let us assume there are a substantial number. Let us assume you are right. Let us assume there are 14 million people who are early retirees not covered by Medicare who do not have any health benefits. Isn't there a difference here between these two groups? Aren't we talking about a promise that has been made by a corporation? LTV certainly made a promise. When a promise like that is made, are you saying we should not do anything about it?

Mr. GOLDBECK. No, I did not say that at all. I said——

Chairman HEINZ. All right. I just wanted to clarify that.

Now I have a question, probably a naive one since I am not a lawyer, for Mr. Baird. If a company goes into chapter 11 or chapter 7—let me start again. A company pays its employees monthly, and they pay you for the month of July on the 1st of August. And on the 29th of July, the company goes into chapter 11 or chapter 7. What is the status of the 29 days of wages that they owe their employees?

Mr. BAIRD. Under the existing Bankruptcy Code, wages earned within a short period before the filing of the Bankruptcy petition and pension obligations that are not yet funded have the status of priority claims. In fact, retiree health benefits do as well, but only those accrued within the 6 months before the filing of the petition. This is not going to help most of the people who are already retired. These priority claims come after all the secured creditors. They come after all the expenses of the bankruptcy proceeding, but they come before the Federal Government as tax collector. They come before the vast majority of unsecured creditors.

Chairman HEINZ. So they have a preferred status.

Mr. BAIRD. They have a preferred status, but the way the bankruptcy law is written, they are still not supposed to be paid until the bankruptcy proceeding is over.

Chairman HEINZ. I understand the timing issue, but nonetheless, they have a preferred status.

Mr. BAIRD. To the extent of $2,000, yes.

Chairman HEINZ. Only $2,000?

Mr. BAIRD. Yes.

Chairman HEINZ. Now, why should not deferred compensation to the same extent, $2,000, for health benefits that have been promised, since they clearly represent a form of compensation, why shouldn't they have, as a matter of legal logic, the same kind of status as wages that in a sense were deferred, too; they just did not get paid before the company went into bankruptcy.

Mr. BAIRD. I would agree they are analytically the same, and they should be treated the same, though——

Chairman HEINZ. But they are not, are they?

Mr. BAIRD. But they are not, because first of all, the $2,000 cap applies to wages, pension benefits, and perhaps to these——

Chairman HEINZ. Is the $2,000 cap per employee?

Mr. BAIRD. Per employee, yes.

Chairman HEINZ. For all of those?

Mr. BAIRD. For all of those. And I do not think there is any problem at all amending that part of the Bankruptcy Code to include all retiree health benefits in that same category. If they are analytically the same, why not treat them the same? I think it is a mistake to think that that change in the Bankruptcy Code will really cure the underlying problem.

Chairman HEINZ. No, it will not. I do not think we are under any illusions about that. I just wanted to clarify that particular area. One thing Congress could do, we could raise the cap.

Mr. BAIRD. Yes.

Chairman HEINZ. We could make it entirely clear that health benefits are protected—it is an option, one of many options. I want to discuss during our time together some other options.

Now, let me go back to Mr. Dudovitz. One of the options you mentioned, Neal, was vesting—not necessarily with funding, but vesting. Now, if retirees were fully vested, would retiree benefits need to be represented in a collective bargaining process?

Mr. DUDOVITZ. If they were vested, I think they would be protected even if they were not a mandatory subject of collective bargaining. For example, pension benefits are protected because they are vested. The law treats them differently than health benefits. So that even if there was no obligation to bargain for retirees, if the benefits were vested, it is my understanding of the law that they would be protected.

Chairman HEINZ. Can you also clarify for us the status of a retiree who was a member of a union. By definition, I suppose retirees are not active members of unions, and as I understand it, they do not have the right to vote approval of collective bargaining agreements. If I am right on that—and I am not an expert on labor law like Mr. Ryan, and he may correct me. Are retirees genuinely covered now by the collective bargaining process?

Mr. DUDOVITZ. Well, they can be covered if the union and employer decide to bargain over retirees rights; but, retirees do not have any right to participate in that process. That is my understanding of the law.

Chairman HEINZ. That is why you recommend guaranteeing retirees, giving them a mandatory right for the union to bargain for them.

Mr. DUDOVITZ. Yes. I think they have a lot to lose or gain by that process. As we can see, at least by the status of the law today, what that collective bargaining agreement says about the employer's obligations to pay health benefits in the future is critical for retirees.

Chairman HEINZ. Would a retiree be better off, or would there be no difference between getting a vested right in a health benefit postretirement—not necessarily funded, mind you—and being mandatorily protected by Federal law by being a guaranteed subject of bargaining, the union having bargained for them a health benefit right postretirement?

Is there any difference between those two situations?

Mr. DUDOVITZ. Well, I suppose there is some difference. My gut reaction is if they were vested, that would alleviate a lot of the problems; but, as you point out, not necessarily funded means that——

Chairman HEINZ. Well, in neither case, unless the union bargaining agreement provides for funding, would they be funded.

Mr. DUDOVITZ. That is correct. And that is why I say I would have some concern because it seems to me there are still things that could happen in the collective bargaining process—where the retirees would have some interest. They would be better off than now if they were vested, and it would alleviate a lot of the problems if they were vested. But I think there still may be some issues that they would want to participate in, or would certainly have some interest in participating in.

Chairman HEINZ. Let me ask Mr. Goldbeck and Mr. Ryan—and I note the presence of Senator Chiles here—what would be your attitude, either one of you, about Congress vesting such benefits—not with funding. I am not saying we are going to do an ERISA-type solution, but just vesting.

Mr. GOLDBECK. I think Mr. Dudovitz' analysis is basically correct, that the vesting by itself—and I think this is the same conclusion that your staff report basically comes to—vesting by itself probably was pretty minimal value in the influence of whether or not dollars ultimately end up available to pay for anything. It may give some sort of succor to the sense of obligation, but if there is no funding, then that is at best a sense of obligation that does not really get you very far.

Chairman HEINZ. I understand that, but Mr. Baird made the point in his testimony that it is certainly better to be vested in a bankruptcy proceeding than not to be. So my question to you or Mr. Ryan. Let me ask Mr. Ryan, for the Washington Business Group on Health—you represent 200 reasonably thoughtful corporations; you have been quite progressive in many respects in this area. What would be the attitude of the employers toward the vesting of these benefits?

Mr. RYAN. As any lawyer, I guess, would tell you, my views really do not make that big a difference; it is views of the association's members that count. At this juncture given the fact that they have only had 2 days to really look at the staff report, I do not think the association has a position.

Chairman HEINZ. Well, with all due deference, I think we have an excellent staff, but I would not accuse the staff of having come up with strictly new ideas.

Mr. RYAN. I will give you my own personal views, Senator, but I do not think I can speak for the Washington Business Group on Health with regard to it.

Chairman HEINZ. Willis, do you want to tackle that one?

Mr. GOLDBECK. He is correct. There is not a formal position on this from the organization. The trend we hear from companies, from individual firms commenting on this issue, is that vesting is not a particularly popular idea. They do not wish to see the medical benefits moving in the direction of pension-ERISA benefits, or what is sort of loosely called the "ERISA-fication" of benefits.

Chairman HEINZ. Among those who have the biggest problem with it, what would be the nature of their problem, other than the fact that they would not like to see anything happen?

Mr. GOLDBECK. I think, as you would well expect, most large employers would like to retain the greatest degree of flexibility over

the benefit structure that they possibly can. And I think that that is the reaction they would have. I do not think it is a relative problem in a statistical sense at all.

Chairman HEINZ. Now, earlier I mentioned the fact that we have provided for an 18-month period in COBRA that gives laid-off employees the right to participate in health plans. How would employers react to that as an option here?

Mr. GOLDBECK. Well, I am sure you have been aware that most employers were not thrilled by COBRA to begin with, and adding onto it is not going to be treated with great joy.

Chairman HEINZ. Can you explain why, because in theory, since the laid-off employee is supposed to purchase health insurance at cost, it should not cost the corporation anything.

Mr. GOLDBECK. There is a distinction. In fact, it is reflected in your report. In one place where you talk about this as a continuation as a potential option, on page II at the beginning, it refers to "at the cost of coverage." Later it talks about "at an equal premium cost." And there is emerging a fairly important distinction between those two. COBRA was at premium plus 2 percent, which is not in many cases turning out to be adequate for a population group that consumes a larger share of medical care.

Chairman HEINZ. Let us assume for the sake of the discussion we really are talking about at cost, irrespective of the fine print of COBRA. Then, how would employers feel? It would seem to me that if it is not costing them anything that they would not have any reason to be in opposition to that.

Mr. GOLDBECK. Obviously, you are quite correct that the more you ameliorate any economic impact, the more you reduce any economically negative response to it. I think that the reaction that you are getting about COBRA in general, and would to this, is a negative response to the increasing numbers of both State- and Federal-mandated benefits. That is a visceral as well as an analytical response. These mandates frequently number in the dozens per company—it is not one or two by any stretch of the imagination—so any additional requirements are not being treated with favor.

I think there is a fine degree of logic to your feeling that this methodology, if used at all, might well be more helpful applied to this kind of a population than some others. Certainly, there would be an equal legitimacy to doing so from the standpoint of protection. But I cannot tell you that the employers would like it.

Chairman HEINZ. Mr. Ryan, let me ask you as a lawyer—I am not a lawyer; you are——

Mr. RYAN. You are doing a pretty good job of it so far. [Laughter.]

Chairman HEINZ. Flattery will not get you as far as you want here. [Laughter.]

Chairman HEINZ. In recent court decisions that I am referring to, like the *White Farm Equipment* case, those decisions have held that reservation clauses—those nice little paragraphs that say, the company does reserve the right to change the plans and if necessary, discontinue them, may not be enough to reserve the right of the employer to terminate retiree health plans or reduce benefits.

Now, how are retirees revising their materials for employers to reserve this right, and do you think they are going to be successful in limiting their liability for retiree health?

Mr. RYAN. Most of the corporations in the United States, larger ones that have health plans of the type we have been discussing here, since 1983 have been reviewing their plan documents, reviewing the summary plan descriptions, and attempting to adequately reserve the right to modify or terminate their benefits.

It is very interesting, Senator. One of the discussions that has taken place over the last couple of years is how do you modify that language, or how do you strengthen that language to protect yourself—that is, the corporate citizen protect itself—without unduly scaring the retiree or employee as to the benefits that will most likely be provided during retirement. And that is a fine line to walk.

Chairman HEINZ. Well, that may be, but that is not my question. My question is there have been a series of court decisions that early on established in many cases the fact that companies did have an obligation to pay these benefits. We had an example in the case of the Teledyne situation where the plant was closed, but after 4 years of heartache, wrangling, and litigation, that case was won by Mrs. Grimaldi and people like her. It is my understanding that companies are finding ways to rewrite the agreements, collective-bargaining agreements, so that is not the case, so they do not have those kinds of obligations, and so Mrs. Grimaldi or people like her will lose in future court decisions.

Is that correct?

Mr. RYAN. Senator, I really do not think you can state the question that way. It is accurate, but it is simplistic, because we are dealing with——

Chairman HEINZ. I am only interested in whether it is accurate and true.

Mr. RYAN. But we are dealing with multiple groups here of employees, and for each group of employees, there are different sets of rules. With a collectively bargained plan, you are dealing not only with wage, unionized employees; we are also——

Chairman HEINZ. I understand that. I am just trying to figure out what is going on out there in the real world.

Mr. RYAN. What is going on is that everything is in a state of flux, Senator.

Chairman HEINZ. Let me ask Mr. Dudovitz or Mr. Baird, as observers, is there a trend out there, and if so what is it?

Mr. RYAN. Senator, I think I can give you the trend.

Chairman HEINZ. Oh, what is it?

Mr. RYAN. The trend is that the courts are now looking at the plan documents to see if the company unambiguously reserved the right to modify or terminate benefits. If they unambiguously reserve the right, I think the best reading of the law is that they can change benefits for retirees.

Chairman HEINZ. Yes, that is the trend in the courts. I am interested in the trend among employers.

Mr. RYAN. The trend among employers is to make sure that the plan documents unambiguously state that you can reduce or terminate benefits.

Chairman HEINZ. And failing that, that they are ambiguous.

Mr. RYAN. The problem, Senator, is that it is relatively easy for lawyers to restate or to state a reservation of rights. The problem is——

Chairman HEINZ. I gather there is no disagreement—and this is all I am trying to establish—that employers do not like getting stuck with these obligations, and they are trying to write their plan documents so that they have an out. I do not see anybody disagreeing with that, and that was really the sole thrust of my question and it should not take 4 or 5 minutes to establish that simple premise.

Let me ask you not as a representative of a particular group of corporate citizens, but let me ask you this as an individual, and drawing upon your background but not representing the Washington Group on Health, Mr. Ryan. You are familiar with the *LTV* case. I visited with people who were literally in the hospital about to have operations that were really essential to their ability to live. Can we allow people like that simply to be thrown out of the hospital when they have to have a health-sustaining or even life-preserving procedure?

Mr. RYAN. That is the difficult public policy issue that you and this committee have to address.

Chairman HEINZ. Well, how about as a corporate responsibility issue? Is it a corporate responsibility issue?

Mr. RYAN. Senator, I cannot tell you how many hours I have sat in corporate board rooms discussing these issues with chairmen of the boards of large corporations, and it is gut-wrenching for them. No one wants to terminate these benefits. It is not that they just do it willy-nilly.

Chairman HEINZ. Has the issue ever been brought up at a shareholders meeting? I understand the dynamics of corporate board rooms. I have never been a member of a board, but I am a Harvard Business School graduate and not unfamiliar with the way boards operate.

Do you think the shareholders, if the question were put to them that I just put to you, would agonize as long as the board did, or do you think they would say, "Look, a promise made to somebody who is in a life-threatening situation is a promise that ought to be kept"? Or, do you think the shareholders, who are just normal people, not corporate officers who may be paid several hundred thousand dollars or more a year, do you think they would take as long to make that decision as the corporate board?

Mr. RYAN. I really do not know, Senator. I assume that they would feel the way you do.

Chairman HEINZ. I think it ought to be tried. I think someone ought to really put it to a shareholders meeting. If it is so gut-wrenching for the board, what do those people in the board room think we ought to do about it, since they are the ones who are very uncomfortable with it?

Mr. RYAN. Senator, I think they are probably dealing with the issue the way you are. This is an issue that has really just come up since 1983–84, and they are now addressing it, just as your committee is. They have a further complication that this committee does not have, and I would recommend that you are going to have to

take this into consideration. They are also dealing with active employees. And frequently you have a situation where the corporation will sit down with the union, during very difficult economic times, they have to cut back, they have to save money, and you start saving money many times in a manner which will negatively impact retirees. It is a very difficult issue here.

Chairman HEINZ. The answer is that they are going through and they have been going through for 3 years since 1983 what you have described as gut-wrenching sessions. Three years if you are without health care is a very long time; it is even more gut-wrenching for the beneficiary, who does not know whether his or her $10,000, or $20,000 or $30,000 medical bill is going to be paid for or not. They may have heart disease or cancer, you know—3 years is a very long time.

What you are saying is that after 3 years of having faced this, the corporate community is no closer to confronting the issue either as corporations or as public policy than they were 3 years ago. That is what you are saying.

Let me ask you and Mr. Goldbeck a different question. I referred earlier to hearings we held last year on July 29 that had to do with Voluntary Employee Benefit Associations, VEBA's. Employers got very concerned that the tax incentives for the creation of VEBA's were jeopardized by I think it was the 1984 act, and as a result, employers suggested that Congress ought to enact a special funding mechanism for prefunding these kinds of benefits, health benefits being a part of a voluntary employee benefit program.

I think, Mr. Goldbeck, you in particular are familiar with what we went into. Now, one of the things that was suggested was the use of a defined benefit pension plan to fund a cash benefit for retirees to purchase continuation in the employees' health plan—not a defined benefit health benefit, but a defined benefit in terms of a cash contribution.

I think we established pretty clearly that it would be pretty hard to know how to fund a health benefit per se. That was fairly conclusive, and it may be possible—we have not figured out how to do it yet—but better than postponing forever the decision, you certainly could fund a defined contribution to a health insurance plan—$100 per month, $200 per month, whatever that might be.

Couldn't employers be doing something like this under current law?

Mr. GOLDBECK. Under current law, the closest you get, as I understand it under current law—some of the others may wish to add to this—is in the 401(h) category, which gives you certain prefunding opportunities. And some firms such as RCA, that we give you a specific example of in our written testimony, have used that vehicle. Some companies are really quite strong supporters of varying prefunding approaches, even to the extent that some of the problems with 401(h) are considered less significant than the benefits. Others feel quite differently. There is no unanimity of opinion on this, which I think is reflected in the fact you do not see a great many of them using that vehicle.

There was a lot of testimony and a lot of concern back at the time of the VEBA debate that companies had not used these benefits, and therefore, there was no real reason to extend them or to

continue them. I think that was an unfortunate reaction because it was predicated on a period of time in which the problem was not even being dealt with or perceived.

Today, I think if you had other vehicles, probably a range of vehicles that would suit different circumstances, you would find that they would be increasingly used, and the problem would be ameliorated, albeit certainly not resolved.

Chairman HEINZ. Let me ask you this. The mechanism by which pension benefits are defined, either defined benefit or defined contribution plans, which they are insured under ERISA, is a vehicle that has been used to my knowledge strictly for pension benefits. Frankly, I cannot see any difference between a defined benefit that is to be a cash contribution, specified as *x* dollars per month, with maybe an inflation escalator, between that kind of a benefit and a contribution to a pension plan. I pose this question to the entire group. Wouldn't it be possible, if an employer were willing, for them to use the same ERISA mechanism to establish, vest, fund health insurance benefits as I have just described them, a defined benefit in the form of a cash contribution to a health insurance plan, under existing law? Is there any barrier to that that you know of?

Mr. GOLDBECK. I do not know of a barrier, but I am not a pension lawyer, and I clearly do not know the rules.

Chairman HEINZ. Mr. Ryan, can you shed any light on that one?

Mr. RYAN. I do not think there is a barrier, but there is no tax incentive to do it.

Chairman HEINZ. Why wouldn't that be tax favored?

Mr. RYAN. A pension plan must primarily provide retirement pension payments, not health benefits. However, the Internal Revenue Code permits limited deductions for employer contributions used to fund postretirement medical benefit accounts which are part of a pension plan. In health and welfare plans which are not pension plans, I think that at least from a prefunded standpoint, in DEFRA you basically said that you could not prefund for the retirees, at least you could not fully deduct those amounts.

Chairman HEINZ. Could not pre-fund a VEBA. But we are talking about basically just an additional cash benefit in a pension plan.

Mr. RYAN. You are talking about taking it right out of the plan now; OK.

Chairman HEINZ. You could say, if you want to simplify the discussion of it, instead of the pension plan paying $300, it is paying $400, but that extra $100 is dedicated to this purpose.

Mr. RYAN. In fact, Senator, I believe there are IRS regulations that permit the retirees to give their consent to an employer sponsor of a defined benefit plan so that funds can be deducted from their pension payments and used to pay for health benefits directly.

Chairman HEINZ. Well, I guess, unless there is disagreement here, what I understand is that an employer who promises the retirees who vest in pensions health insurance could, as of today, under current law—Congress would not have to do a thing—could create a vested situation and a funding stream and Federal insurance of that vesting under existing law.

Is that not correct, Mr. Baird? You are the legal scholar.

Mr. BAIRD. I do not pretend to be an expert in pension law, but that would be my understanding.

Chairman HEINZ. Mr. Dudovitz?

Mr. DUDOVITZ. I think you are partly right, Senator. Certainly they could create it, and it would be vested. I have not really researched it, but I am not sure that the PBGC would insure that benefit, because there are limits on what the Pension Benefit Guaranty Corporation insures.

Chairman HEINZ. Well, it might not be insured, but it would be a funded mechanism, and it would be a tax-favored funded mechanism.

Mr. DUDOVITZ. I think in essence what you are saying is that it is a form of a pension benefit, and by calling it that—which, if I were representing a retiree, that is exactly what I would call it—you plug right into ERISA.

Chairman HEINZ. Gentlemen, my feeling is we have done a pretty good job of covering the ground here. We have talked about the treatment of these benefits as deferred compensation; we have gotten into the legal philosophy of that a little bit. We have discussed the difference between vesting and funding. We have discussed the opportunities under current law. We have discussed to a certain extent the various situations where a plant has closed, where an agreement has expired, where bankruptcy takes place.

Actually, there is one area—we did not get into the question of where a collective bargaining agreement—and this was the situation that Mr. Harris found himself in—what happened to him was the collective bargaining agreement, as I understand it, expired, and because the basis for his health benefits was a promise in a collective bargaining agreement, when that expired, he was down the elevator shaft.

Would vesting him have prevented that, Mr. Baird?

Mr. BAIRD. If I understand——

Chairman HEINZ. The company continued in business, I think, and is profitable.

Mr. BAIRD [continuing]. The question is the nature of the promise the company has made. It is conceivable that—and I think it is likely—that the nature of the promise is one like unpaid wages, one like deferred compensation. If that is the case, it does not matter whether the collective bargaining agreement has expired. If there is a collective bargaining agreement, and the company promises to pay wages or health benefits or whatever in return for work done while the agreement was in effect, then the health benefits that have to be paid in the future arose out of that agreement. It does not matter whether the agreement continues, if the obligation is for work already done.

On the other hand, if the promises to people like Mr. Harris simply arise out of a result of an ongoing collective bargaining agreement and are not specifically deferred compensation to him, but simply a promise the corporation makes for having the workers work for this period of time, being that it will pick up health benefits during the duration of the agreement, of existing and past employees, then of course when the agreement expires the retirees are out of luck. It depends upon the characterization of the promise.

Chairman HEINZ. The last overall area that I want to put a final dot or comma on is if we do not do something, what are the alternatives? If we do not do something that causes employers to do a better job of maintaining the promises that they have made what will happen? I do not think anyone in Congress is trying to require employers to have for all their employees in all situations a guarantee of health benefits. What we are talking about today are promises that have been made but which have been broken, for a variety of reasons and in a variety of circumstances.

Willis, as I understand your testimony, what you said was that you questioned whether or not an employment-based system for maintaining these promises was the right approach. My question to you is if Government did not make the promises, and business did, why should Government have to pay for those promises, because at some point the basic sense of fairness and justice that the American people have for promises is going to assert itself.

Mr. GOLDBECK. My comment about the employment-based approach was to the broader issue of whether that is the best vehicle for providing medical care coverage for all retirees, not just those for whom a promise has been made, and the contract then apparently broken.

I think what you are hearing today—and I would want to footnote it if it has not been clear—is that there are not going to be retiree medical benefit plans with that promise in them. That is not going to be the issue. We have a period of time and a group of people who are at risk right now. Some are from companies where there was in fact a promise of benefits that, if the current court cases are upheld, was a contract that cannot be withdrawn. Even these people may not be protected in case of bankruptcy.

But the vast majority of retirees are not in that circumstance, and I will try and quantify that group for you in the future. The reality is that the crisis which precipitated these hearings is not the circumstance you are going to have to protect in the future, because that is not the way plans are going to be written.

Chairman HEINZ. My understanding is there are roughly 30 million early retirees—is that about right? [Conferring with staff.] Let us try that again.

There are a large number of these people. [Laughter.]

Mr. GOLDBECK. It will be my pleasure to share this data at some future time.

Chairman HEINZ. I do not have any better statistics than you do. But they clearly have what can be, as we have seen, some very serious problems. Conceptually, what is the answer? Is it national health insurance? Congress is not really willing to junk the private-based insurance system and do that. Is it catastrophic coverage? Is it a mandatory buy-in? We discussed that. Is it a mandatory risk pool operated through the States?

What conceptually is the answer to this overall problem?

Mr. GOLDBECK. I do not believe there is a single answer. In other words, I would not take any one of those items and say there it is. For instance, one law just went into effect on August 1 that has an impact, hopefully a positive impact. It was a law that you among others were associated with, the antidumping law. A person, such as the LTV person that you visited in the hospital, would not by

law as of August 1 be able to be dumped out because of the absence of insurance. They could be eventually moved to a charity hospital, but they would not be just dumped on the street and told to go away. They have to be moved relevant to their medical circumstances and only, in fact, if the move would not in any way jeopardize them medically. That helps some people. It is a nationwide solution.

You asked me to speak conceptually. What I will describe is not a position that the organization has taken but we have a group starting to look at the problem of people trapped by a sudden termination. The approach is a retiree medical benefits review board. It is not the Pension Benefit Guaranty Corporation because there is not the funding structure to just do that. When a company was heading into bankruptcy, or let us say they literally went under, or wished to terminate their medical plan, that plan would be presented to this board. The board would not have to be a new agency as such. It could be staffed on an on-call basis with people from Labor and Commerce and the respective agencies that are relevant to the subject. They would review whether there was a reason to initiate arbitration or mediation prior to going into court. They would have the authority to establish an immediate benefit continuation plan, for example, 90 days, so nobody fell through the cracks on day of notification. They would have the authority given, obviously, by Congress, to access Medicare or Medicaid for, say, 90 days if the company had no or insufficient assets. The list can go quite lengthy as to the various mechanisms that an authority could be created to use on a short-term basis to try and address this issue of the people who fall through the cracks. That does not solve, and it is not designed to solve the problem of some gentleman, for instance at age 56 who then has to look for insurance for the next 9 years. But it certainly says that there would never be the circumstance where you would have to pull your wife out of the hospital tomorrow afternoon because suddenly you got a notice in the mail.

So I think you are going to need to use some of the mechanisms that you spoke to, but also to create something that explicitly addresses this crisis for those who are falling through the cracks. That is a separate issue than how do you deal with prefunding, vesting, the longer term issues, and all the rest of retirees.

That is one conceptual idea to consider.

Chairman HEINZ. One last area of inquiry I would like to conclude with is that one who has been through the mill—and the four of you have not, and I have not—but there are of people sitting behind you who have, who did go through the mill and, at least in one case, is very much going through the mill right now, Mr. Harris. Now, to them, it would seem that Congress ought to say, look, companies promised a benefit, by golly, they promised it; we ought to be vested in it, assuming we have worked for a company for 25 years or some reasonable period. That vested benefit does not mean a thing unless it is funded, so it ought to be funded. Then we would have some assurance that a promise once made would be a promise delivered on. It might not always be delivered on. The company might go into bankruptcy, and the plan might not be adequately funded, it might not be actuarially funded—LTV certainly

has not funded all its pension plan, and those are supposed to be funded.

Let me ask Mr. Goldbeck, if we did pass that law, what do you think employers would do, really do? And I ask you, Neal, because you are not an employer and you have some objectivity about what they would do. Would they continue the health benefits they have? Would they enhance them? Would they drop them? Would new employers establish them? Would that be a serious disincentive to employers either maintaining or creating the health benefits that now exist?

Mr. DUDOVITZ. I suspect some employers would in fact end their health coverage. I believe we have to rely somewhat on the marketplace in terms of how important it is for workers to have those health benefits. That is essentially what the question is.

I am much more interested in having people know what their rights and benefits are. I found interesting Mr. Ryan's comment that the employers are scared to tell people that they may lose when they are in retirement.

I have confidence in individuals. If they know what the situation is and they have some opportunity, they will try to take care of themselves.

The worst thing you can do is promise with one hand and then when they turn their backs, take it away. I am scared because I would hate to see employers be willing to take it away. But, I would rather have them tell people right up front now that, "When you get in retirement, you may not get your benefits," so people can be prepared. So people can plan.

Chairman HEINZ. That brings up a rather interesting issue that I had not thought of. Suppose we just pass full disclosure legislation, and we say really there are four options that a company can have—a company has to in the case of employees where there has been a promise of health benefits upon retirement, they have to let them know one of four things: First, there is absolutely no guarantee that the benefit is going to be paid if we go into bankruptcy; second, there is no guarantee, but you will get your benefit if the plant you work at closes; no benefit if the company goes into bankruptcy, third, you will not get your benefit if the collective bargaining agreement expires, or alternatively, you will get it; and I suppose the fourth alternative—and there might be six, there might be five—is this benefit is not only vested, but we have funded it in accordance with ERISA standards. A company would just be required to check one of those boxes every time they make a deal with their employees.

Is there anything conceptually wrong with that? Wouldn't that be a lot more honest?

Mr. DUDOVITZ. Sure. I absolutely agree it would be a lot more honest. It is in essence what the courts are beginning to require. They are saying that these general clauses are not good enough, that the wording has to be explicit and unambiguous if an employer wants to be able to terminate or reduce those benefits. And the courts are bending over backwards in favor of the retirees at this point.

I think it is absolutely better to have that information. And I would ask the question as to why are employers worried about

giving that information to people. Is it because they think they will not accept those facts and will demand different benefits? Maybe, in fact, the workers will demand that they get those health benefits when they know that there is some risk of losing them.

I believe workers have the right to know what they are bargaining for when they take a job.

Chairman HEINZ. Let me ask Mr. Baird, would it be feasible to have this kind of unambiguous disclosure?

Mr. BAIRD. I think you could draw an analogy to the Magnuson-Moss Warranty Act. That act solved a consumer problem that used to exist. You would buy a television and get something that was gilt-edged and said Warranty when in fact, if you read all the fine print, which no one did, it said you were not getting anything. The advantage of this kind of proposal is that you could implement it through fines and the like to make sure that a company that did not jump through the right hoops, and did not present these things in the right form, would be fined and be fined long before it became insolvent or ran into difficulties.

I think it is a fine idea, and I think you can look to the Magnuson-Moss Warranty Act not as a perfect model, but as an analogy. It is a way of informing consumers and not letting companies use words like Full Warranty, when in fact they are not promising anything.

Chairman HEINZ. What do you think, Mr. Goldbeck?

Mr. GOLDBECK. Our organization has, I think, really been the loudest voice in asking for full disclosure of provider data for the whole health care system. Therefore, we could hardly turn around and say, "But we do not think it is right for employers to disclose information to employees."

Most of the employer reporting responsibilities today to the Department of Labor, in fact require that they stipulate to the employees the condition of their benefits plans. Now, there is a big difference between the language used for reporting officially in response to Government regulation and the language that the average citizen fully understands or even reads with great attention. That raises the whole other issue of implementation.

But most of the requirements that you are talking about in fact exist, and we would certainly not argue with the fact that employees should know the actual condition of their benefits.

Let me draw one distinction between this general disclosure and the question which was raised earlier, and is a possible recommendation in the staff report, to establish a requirement that if a company is going to go bankrupt, it notify the employees 6 months in advance.

Chairman HEINZ. Well, that is not the proposal. The proposal is a little more sophisticated than that. It is that there be no withdrawal of health benefits for 6 months after notification. I think that is the more accurate way of describing it.

It may be misstated, but that is really, I think, what it intended.

Mr. GOLDBECK. Wonderful. But it will only work if the company actually has assets to pay for the 6 months of benefits.

Chairman HEINZ. I am glad you brought that up because I was going to if you did not. What that says is, if you are going into bankruptcy, and you promised benefits, and you have not notified

people ahead of time, you have got to pay benefits for 6 months. That is the effect of that particular option.

Mr. GOLDBECK. Which would tie you back into some of Mr. Baird's earlier comments about the difference between——

Chairman HEINZ. To a certain extent, although what Mr. Baird generally talked to was Congress giving kind of an open-ended preferred status. This is very closed-ended. Indeed, it is what LTV essentially agreed to.

Mr. GOLDBECK. I realize that.

Chairman HEINZ. What would be the effect of that? It seems to me it is a fairly limited time period. Let us put it in the worst case, that what it really requires is the continuation of health benefits for 6 months, at which time the company can do whatever it wants to do or could do under what the court of competent jurisdiction will let it do. At least I think the concept there is, well, let us give people some time to find out where they stand.

We heard from my constituents, the Taylors, that they really do not know where they stand.

Mr. GOLDBECK. Well, as I understand it, and also as you have reported it today, in fact, the LTV obligation is now clearly established by the court.

Chairman HEINZ. Well, no, it is not. It is not clear. It is absolutely unclear.

Mr. GOLDBECK. I thought you said they had an agreement.

Chairman HEINZ. No, no. Teledyne made the settlement and had the agreement. The judge agreed to an LTV request, 2 hours after we passed the legislation to continue health benefits for 6 months. However, that is subject to a redetermination. Let me clarify that.

Mr. Baird, could not a creditor go to the judge tomorrow—and maybe they are doing it right now—and say, "Listen, you are creating a preferred status that jeopardizes a prior claim that I have. I am a secured creditor, and you are undermining my security."

Isn't it conceivable—indeed, if you want to judge whether or not it is likely—isn't it quite conceivable that the situation of the Taylors could change tomorrow?

Mr. BAIRD. I agree. Bankruptcy judges are notorious for changing their minds. In addition under the agreement to continue health benefits, LTV is reserving its right to treat all these retiree health benefits as unsecured claims. In other words, anything the retirees are paid for the next 6 months could go toward anything they eventually get out of the reorganization. What the retirees are getting now may not be merely a continuation for 6 months, but rather may count to whatever they get in the eventual decision.

Chairman HEINZ. May count against their 10 or 20 cents on the dollar.

Mr. BAIRD. Yes.

Chairman HEINZ. So that is one downside. The other downside is that the judge could change his mind tomorrow.

Mr. BAIRD. That is right.

Chairman HEINZ. What kind of showing would a creditor have to show a normal bankruptcy judge, if that is not an oxymoron?

Mr. BAIRD. Well, if the secured creditors can demonstrate that the retirees have unsecured claims, and if they can also demonstrate that the unsecured claimants are not going to get anything

in the bankruptcy proceeding, then they would have a fair chance of convincing the judge not to make those kinds of awards, especially if it were clear that the company were not going to continue as a going concern. Without being too much of a Cassandra, I would point out that LTV is a group of 65 different corporations. Some are engaged in aerospace and may continue for a long time. But others of these corporations may in fact not continue as going concerns.

Chairman HEINZ. If Congress requires the 6-month continuation of benefits that we were just discussing a moment ago with Mr. Goldbeck and Mr. Dudovitz, how would that fare in court?

Mr. BAIRD. If it applied generally, not just to a particular debtor—not just to LTV, but you are talking about——

Chairman HEINZ. Yes, this would be a generic law that applied to any employer in chapter 11, or maybe chapter 7 as well, that if they had bargain-promised health benefits, they would have to continue those benefits for 6 months.

Mr. BAIRD [continuing]. Well, the other way to do it is to simply require 6 months and to say this holds true whether or not they are in chapter 7 or in chapter 11.

Chairman HEINZ. Right.

Mr. BAIRD. There is no——

Chairman HEINZ. Congress could require that, could create a totally preferred lien, if you will.

Mr. BAIRD [continuing]. It could create in effect a statutory lien. There are two cautions I would give. One is a technical caution. Such a change may require some amendments to provisions of the Bankruptcy Code that limit statutory liens. There is no problem changing those, but you would have to do it as part of the bill as a technical matter.

Chairman HEINZ. Presumably, our philosophical justification would be that this is deferred compensation.

Mr. BAIRD. The philosophical justification is that deferred compensation deserves a priority status. You have to make the determination that these people are more deserving than others. I am not saying there is a problem in making that determination, but if you——

Chairman HEINZ. No; Russell Long is very clear on that. He says over on the steps of the Supreme Court, it is justice that is blind. Justice is not supposed to know who she is helping or who she is hurting. Up here in Congress, we are supposed to know who we are helping and who we are hurting. Russell Long insists that he particularly wants the people we help to know who helped them.

Mr. BAIRD. No; there are certainly no conceptual problems with doing that.

Mr. GOLDBECK. Quite apart from the conceptual issues, there is the reality that a number of the companies that obviously face the worst problems are those that have in some cases, more retirees than active workers. You are looking at some cases where a 6-month benefit extension could be $50 million, $100 million. The morality issues to the side, the fact remains that there are a lot of companies that simply will close their doors. That is part of American history. They are not going to close their doors with a $50 mil-

lion bank account, because if they had that, they would not be closing their doors.

So in some cases, the statement by Congress that the bankruptcy laws now make provision for retirees to get to the front of the line is going to be the front of a line for which there are no resources to be distributed. So it will not solve all the problems.

Chairman HEINZ. What you are stating is quite accurate. It is a zero sum game.

Mr. GOLDBECK. Yes, sir.

Chairman HEINZ. If a company is headed toward chapter 11, the numbers do not add up to solvency. They add up to less than solvency. There is a sharing of claims against that company.

Now, in chapter 11, the idea is to permit the company to continue to survive with some rationalization of the claims of those creditors. In chapter 7, of course, it is a question of dividing up the pie or, if you will, the skeleton, to see who gets the largest hank of hair and piece of bone. Most of the situations we have been dealing with have been conceptually chapter 11, and they are in some sense more difficult than chapter 7.

Mr. BAIRD. I would add that if obligations to the retirees exceed the assets of the corporation, then of course these obligations will not be met. The corporation will not have the assets.

Also I would point out that most chapter 11's end up in chapter 7, just as a factual matter——

Chairman HEINZ. As a statistical fact?

Mr. BAIRD. As a statistical fact. Now, that does not necessarily mean that that is true of these large bankruptcies which in fact are rare events. There are thousands of chapter 11's every year, and very few of the size and magnitude of LTV or Manville.

Chairman HEINZ. Gentlemen, thank you all very much. It has been a most helpful and productive discussion. I hope that out of it, we can find a consensus, because these promises that are made at the very minimum need to be clear, they need to be unambiguous. We need to find a solution that does not discourage companies from making these benefits available to their employees. That would not be a good solution. At the same time, we would like to see employees, once they have received a promise, have it have some meaning to them.

Thank you very much.

[Whereupon, at 12:10 p.m., the committee was adjourned.]

APPENDIX

MATERIAL RELATED TO HEARING

Item 1

RETIREE HEALTH BENEFITS:

THE FAIR-WEATHER PROMISE?

A Staff Report

U.S. Senate Special Committee on Aging
John Heinz, Chairman

August 7, 1986

PREFACE

The report herein examines a disturbing and growing trend which threatens the very health and welfare of older Americans. An increasing number of companies are attempting to cut costs by cutting or cancelling retiree health benefits. These vulnerable benefits -- which are neither protected by federal law nor, except for a few, prefunded by employers -- represent the only health care coverage for three million retirees under 65 and a critical supplement to Medicare for more than twice that many over 65.

Continued health coverage in retirement is a benefit promised to 84 percent of employees of large firms and nearly half of those working for firms with 100-250 employees. Today, seven million retired Americans count on employer-sponsored health insurance. Millions have been lured into early retirement by the promise of continued health benefits. However, a growing number of retirees are finding such benefits a fair weather promise.

In failing and troubled industries, such as auto and steel, liabilities for retirement benefits have become a significant debt and a major part of the labor cost for employers. Nationwide, the liability is estimated to be $98 billion. Companies who file for bankruptcy to reorganize their debt and reduce their labor costs increasingly are drawn to terminating pension, health, and life insurance plans for their retirees. Retirees suddenly find the promise of health benefits for life is a promise a company can break with the click of a lock on the factory gate or the bang of a door on the bankruptcy court.

In the absence of the protections afforded by federal law, the courts have played the lead role in defining the rights of retirees to continued health coverage. The courts have made it clear that Congress has provided no statutory protection for retiree health benefits. In fact, protection rests solely in the contract retirees have with their employer. Employers clever enough to place limits on their contract promises may have no obligation to pay.

The simple solution would be for Congress to step in -- as we did twelve years ago with pensions -- and make these benefits permanent at retirement. But we also need to recognize the chilling effect this would have on the employer's willingness to even offer these benefits. Employers already hesitate to offer health coverage in retirement because the costs are open-ended and hard to control.

Congress must find a way to safeguard the health of our Nation's retirees and prevent promises from being broken. Our goal is to make the pledge of retiree health benefits secure in fair or foul weather. Our challenge is to combine this goal with reasonable, defined limits for employers.

JOHN HEINZ
Chairman

RETIREE HEALTH BENEFITS: SECURITY ISSUES

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RETIREE HEALTH BENEFITS: THE FAIR WEATHER PROMISE?

A Staff Report of the Senate Special Committee on Aging

August 7, 1986

EXECUTIVE SUMMARY

INTRODUCTION

Today seven million retired Americans count on health insurance from a former employer as the only coverage prior to age 65, or as a supplement to Medicare after 65. However, a growing number of retirees are finding such benefits a fair weather promise.

With escalating health care costs, higher ratios of retirees to workers in older industries, and pressure to reduce labor costs, companies have started cutting costs by cutting the retiree health benefits they now provide. When an employer closes a plant, declares bankruptcy, or simply amends the plan, retirees suddenly find themselves without health insurance. Especially vulnerable are those retirees who were forced or willingly took early retirement before becoming eligible for Medicare. Buying private health coverage they soon find is very expensive, if even available.

On July 17, LTV Corporation, the nation's second largest steel producer, terminated health benefits for 78,000 retirees without warning as they filed for reorganization under the Bankruptcy Code. While LTV has temporarily restored the plan in response to public pressure, there is no assurance that the retiree's health benefits will be allowed to continue.

WHO IS COVERED BY RETIREE HEALTH PLANS?

- In 1983, an estimated 6.9 million retirees and their dependents were covered by private sector employers' health insurance programs. About three million of these retirees were under 65 and ineligible for Medicare.

- Large employers, primarily, offer the continuation of health care benefits for retirees. In 1980, 84 percent of the participants in firms with 2,500 or more employees were in health plans that continued benefits after early retirement. For firms with 100 to 250 employees, only 47 percent offered continued benefits.

- Out-of-pocket health care costs for retirees not covered by an employer-sponsored plan can run up to a third of their income; 17 percent for those continued in a group plan. As Medicare continues to shift costs to the beneficiary, and health care

costs continue to increase, retirees can expect to pay a greater proportion of their income for medical expenses.

HOW SECURE ARE RETIREE HEALTH BENEFITS?

Retiree health benefits are not guaranteed under federal law, unlike pensions.

• Federal law sets minimum standards for employer-sponsored pensions, requiring that employees earn a non-forfeitable right to pension benefits after a specified period of service. No federal law protects retiree health benefits.

• Absent statutory protections, the courts have found that retirees have a right to benefits only if the employer explicitly or implicitly promises lifetime benefits to them. If employers clearly and unambiguously reserve the right to cancel benefits, retirees are not protected.

Employers have promised an estimated $98 billion in retiree health benefits -- a greater liability for some than their pension obligations -- but few, if any, have set aside funds to pay them.

• Without funding or benefit guarantees for retiree health benefits, the receipt of these benefits will continue to be at great risk when companies file for bankruptcy or go out of business.

• Since Chapter 11 bankruptcies have increased over 200 percent in the past five years, further cuts of retiree benefits can be expected, especially by companies with more retirees than active workers.

SUMMARY OF STAFF RECOMMENDATIONS

Additional benefit protections are needed for retiree health benefits. However, protection should not be legislated in a way that would encourage employers now voluntarily providing coverage to terminate their plans. Action should be taken now to:

• Secure funding: Employers be permitted to fund cash benefits that could be used by retirees to purchase continuation in the employer's group health plan. These cash benefits would be subject to ERISA standards for defined benefit pension plans.
• Guarantee access: Congress mandate that employer's provide access for their retirees to the company's group health plan for the cost of the coverage.
• Require notification: Retirees in employer-paid plans that are not funded should be clearly notified of the risks and provided 6 months advance notice of any reduction or termination of benefits.
• Study protections: Congress should explore a permanent means for protecting unfunded retiree health benefits in full.

I. WHAT ARE RETIREE HEALTH BENEFITS?

MEDICARE IS THE FOUNDATION

Employer- or union-sponsored post-retirement health benefits are group health insurance plans which provide coverage for retirees not yet eligible for Medicare, and which supplement Medicare benefits for retirees aged 65 and above. Medicare is the fundamental health benefit for retirees, covering over 26 million older persons -- almost every American over the age of 65. But Medicare does not by itself meet all of the critical needs of the elderly. The biggest gap in Medicare coverage is that it is not available to retirees younger than age 65. An additional gap is that it focuses, by design, on acute care needs and provides little or no preventive care, long-term care, or catastrophic protection. Even for the acute care it covers, Medicare requires considerable cost-sharing by beneficiaries in the form of a premium, deductibles, and co-payments.

Although the Medicare program pays almost half of the elderly's health care expenses (primarily the costs of hospitalization and a substantial share of the costs for physician services), the elderly require additional insurance to cover all their medical expenditures. As many as two-thirds of older Americans supplement their Medicare coverage with private insurance, often referred to as medigap coverage. Employer- or union-sponsored health benefits can provide an important source of insurance coverage to retirees.

EMPLOYER PLANS FOR RETIREES SUPPLEMENT MEDICARE

Employers who provide coverage for retired employees and their families in a group health plan generally provide full coverage in the company's plan until age 65. Many plans then either adjust coverage in the employee health plan or provide a separate plan to take Medicare benefits into consideration.

Most corporations provide comprehensive health coverage related directly or indirectly to the benefits provided by Medicare. One of two approaches may be used: a "carve-out" or a "Medicare supplement". The "carve-out" continues the retiree in the employees' group plan, but carves out benefits provided by Medicare to avoid duplicate coverage. In a variation on this approach, called "coordination of benefits," the plan pays what it would in the absence of Medicare, but the total payment is limited to 100 percent of the expense. Because this type of plan pays for services the plan provides that Medicare does not pay for, its costs are affected by changes in Medicare benefits.

The "Medicare supplement" avoids this problem by specifying exactly the benefits that will be paid by the plan. In addition, the supplement can tailor benefits to the needs of the retiree. While the costs of the supplement can be more easily controlled, this approach requires the design and administration of a separate

plan. It also may result in a change in benefits for early retirees at age 65.

CONTINUED COVERAGE IN GROUP PLANS PROVIDES VALUABLE PROTECTION

Continued coverage in group plans provides an important protection for many elderly from the prohibitive cost of purchasing supplemental coverage individually or paying costs not covered by Medicare out-of-pocket. If retirees are not continued in group plans, they often have the option at retirement of converting the employer policy to an individual policy. Conversion policies are frequently more expensive than policies sold in the individual market because they are issued without regard to preexisting conditions and there is no waiting period. To pay the premiums for an individual policy, couples age 62-64 would have to spend an average of 56 percent of their Social Security benefits if this was their only source of income. Those with pensions, would have to pay 35 percent of their retirement income in health insurance premiums.

Elderly out-of-pocket health care costs in 1986 will be about $1,850 per person -- an average annual increase of 11.4 percent since 1980. In fact, the elderly currently spend, on average, as large a share of their incomes for health care as they did before Medicare's enactment. Employer-sponsored group insurance can ease the burden of rising health care by the elderly. The Department of Labor estimates that those with group health plans spend a total of 17 percent of their income on out-of-pocket medical expenses (including premiums). In contrast, those with individual policies spend 28 percent of their income, and those with Medicare alone, 33 percent.

Employer-sponsored health insurance provides significant benefits for those who have it. The Department of Labor suggests that for aged retirees in employer-sponsored group plans, private insurance paid for 23 percent of their total health care expenditures in 1977. This is in sharp contrast to the benefits provided under most individual policies. For those with nongroup insurance plans in 1977, private insurance paid for slightly less than 12 percent of total health care expenses.

Since employer-sponsored group insurance offers more extensive coverage, the premiums are often higher than for nongroup policies. In 1983, the estimated average premium cost for retirees 65 and over with employer-sponsored group insurance was $942 versus $353 for those with nongroup policies only. For retirees with group insurance, however, an average of 58 percent ($547) of the premium was paid by the employer, resulting in the individual paying, on average, $342.

Cost-sharing, however, varies significantly among firms. As a result of the dramatic increase in health insurance costs in recent years, companies have increased employee premium contributions in an effort to control their expenses. The 1984 Hay/Huggins survey, for example, found that 46 percent of the respondents have altered

their health insurance plans in the past two years, including increases in the employee's share of the premium and increases in deductibles. The Wyatt Company found that the percentage of firms paying the entire premium for comprehensive major medical policies declined from 52 percent in 1980 to 39 percent in 1984. The same survey found an eight fold increase in the number of plans with deductibles of $100 or more.

The liability for retiree health benefits has become a significant part of the labor cost for employers particularly in troubled industries, such as auto and steel, in which the ratio of retirees to active employees is high. According to the Department of Labor, employers are responding to growing health care costs by shifting from promising a level of benefits to promising a level of contributions toward the purchase of health insurance.

WHO IS COVERED BY CORPORATE RETIREE HEALTH PLANS

Presently, a relatively small number of retired workers are continued in their employer-sponsored group plans. The Department of Labor reported that one out of every six elderly Americans is receiving a portion of their health coverage from an employer or union. In 1983, an estimated 6.9 million retirees and their dependents were covered by private sector employers' health insurance programs. Included in this group are 4.3 million individuals who are over the age of 65. Of the 6.9 million participants, 4.6 million were retired workers. The remaining 2.3 million were dependents of retired workers.

It is primarily large employers who offer this continuation coverage for retirees. In 1980, 84 percent of the participants in firms with 2500 or more employees were in health plans that continued benefits after early retirement. At the same time only 47 percent of the participants in firms with 100 to 250 employees were in plans continuing benefits.

In most companies, employees become eligible to receive health benefits when they retire from the company. In some cases coverage is limited to retirees who are eligible to receive a pension or who meet specified age and service requirements. Employees who do not meet the requirements for benefits at retirement or who leave the company before retirement usually do not qualify for health benefits.

Many plans provide additional coverage for the retiree's spouse and other qualified dependents. These benefits are sometimes provided only if the retiree pays the additional premium costs, and their availability often terminates on the death of the retiree.

CONCLUSION

Through Medicare the government is bearing the major part of the burden in providing health care to the elderly population. In

1984 private insurance only paid 7.2 percent of health care expenditures of the aged. Although private health insurance covers only a small percent of aggregate health care expenses for the aged, employer-sponsored health insurance is a significant benefit for those who have it. The Department of Labor estimates that 6.9 million retirees and their dependents rely upon an employer or an union for their health coverage. Unfortunately, the security of these benefits has been called into question by employers' attempts to modify or terminate health and life insurance coverage for retirees.

II. HOW SECURE ARE RETIREE HEALTH BENEFITS?

As a result of the rising cost of providing retirees with health and life insurance, employers have more and more frequently attempted to reduce or discontinue retiree health benefits. Retirees have brought suit under the Employee Retirement Income Security Act of 1974 (ERISA) and for breach of contract against their former employers to prohibit the denial of promised benefits. The courts have acknowledged the power of an employer to reserve the right to modify or terminate these benefits. Yet, the courts have imposed stringent standards on companies desiring to alter their retiree health plans. Both written descriptions and oral representations of the benefits must clearly and unambiguously establish the employer's unqualified right to alter the plan. When the court has been called upon to interpret ambiguous contractual language, retiree benefits are generally presumed to be provided for life because the status of retirement is for life.

PROTECTIONS UNDER ERISA

Retiree health benefits are not afforded the same protections that ERISA mandates for pension benefits. ERISA draws a distinct line between employee pension benefit plans and employee welfare benefit plans. Employee welfare benefit plans can include medical, disability or death benefits, vacation plans, day care centers, prepaid legal expenses and scholarship funds. Employee welfare benefit plans must comply with ERISA reporting and disclosure requirements and fiduciary standards to ensure that any plan funds are handled properly. However, unlike pension plans, employee welfare benefit plans are not subject to ERISA standards concerning who must participate in the benefit plan, how long a person has to be covered to be entitled to benefits (vesting), or how much should be set aside each year to pay for future obligations (funding). Moreover, employee welfare benefits are not insured by the Pension Benefit Guaranty Corporation (PBGC). The limited applicability of ERISA's minimum standards to welfare benefits was reaffirmed by the 1985 Supreme Court decision, Metropolitan Life Insurance Co. v. Massachusetts.

While ERISA was developed primarily with pension plans in mind, several of its requirements apply to both pension and welfare

benefit plans. Sections 102-104 of ERISA call for the following reporting and disclosure requirements for employee welfare benefit plans:

-- A summary plan description must be furnished to all plan participants and also filed with the Department of Labor. It must be written so that it can be understood by the average plan participant.

-- A summary of any changes in the plan description and summary of any material modifications to the plan must be furnished to each plan participant and also filed with the Department of Labor.

-- An annual report (Form 5500) must be filed with the Department of Labor. This report must include information on plan participation and finances and include schedules on payments to insurance carriers, service providers, or health maintenance organizations.

-- Plan participants must be notified in cases of plan termination, merger, consolidation, or a transfer of plan assets.

Employee welfare benefit plans that (1) cover fewer than 100 participants and (2) pay benefits either through an insurance policy or from the general assets of the employer or employee organization maintaining the plan are partially exempted from ERISA's reporting and disclosure requirements. For example, such plans need not furnish plan participants and beneficiaries with a summary of the annual report.

In addition, plan fiduciaries (those who are responsible for managing and overseeing plan assets) and all those who handle plan funds or property must be bonded. Fiduciaries must discharge their duties solely in the interest of the participants and beneficiaries and can be held liable for any breach of their responsibilities. Plan participants and beneficiaries have the right to file suit in State and Federal court to recover benefits due them, to enforce their rights under the terms of a plan, and to clarify their right to future benefits.

Not only is there a void of Federal regulation governing the security of welfare benefits, but ERISA contains a sweeping preemption clause that supersedes State laws relating to both employee pension and welfare benefit plans sponsored or maintained by employers. Only commercially insured plans regulated under state insurance and banking laws are exempt from ERISA. The absence of statutory regulation concerning non-insured welfare benefits has resulted in considerable litigation to determine whether or not an employer can modify or terminate retiree health benefits in a variety of circumstances.

IMPACT OF RECENT COURT CASES

Because of the absence of a definitive Supreme Court decision in this area, the law is still in a developing state. Several Sixth Circuit cases have become the focal point for analyzing the emerging legal problem. The Circuit Court held in its April, 1986 decision, Hansen v. White Farm Equipment Company (6th Cir. 1986), that an employer was not absolutely prohibited from terminating retiree health benefits. However, the court outlined stringent standards that the employer must meet in order to establish the right to amend the plans in question.

Most, but not all, of the applicable case law involves collectively bargained welfare benefit plans. The issue involved is whether or not employers must continue to provide health benefits to retirees after the collective bargaining agreement expires. In cases where the terms of the contract clearly limit the duration of the benefits, the court allowed termination. [See UMWA v. Royal Coal Co. (4th Cir. 1985), UAW v. Cleveland Gear Corp. (6th Cir. 1984), UAW v. Roblin Industries, Inc. (W.D. Mich. 1983), Turner v. Teamsters Local 302 (9th Cir. 1979), United Rubber Workers v. Lee National Corp. (S.D.N.Y. 1971)]

If the provision of the contract dealing specifically with retiree health benefits is ambiguous concerning their duration, then the courts have looked to other clauses in the collective bargaining agreement that contained durational limitations. In UAW v. Yard-Man, Inc. (6th Cir. 1983), the court concluded that because specific durational limitations relating to other benefits in the current collective bargaining agreement were not applied to retiree benefits, these benefits were intended to survive the expiration of successive agreements. In addition, a general contract expiration clause did not indicate an intent of the employer and employees that all benefits provided by the collective bargaining agreement terminate at the expiration of the agreement. The impact of Yard-Man is that retiree health benefits are presumed to be provided for life in the absence of a clear contractual limitation on their duration.

There have also been cases in which retirees have contested the right of employers to amend or terminate promised health benefits which have not been collectively bargained. In Eardman v. Bethlehem Steel Co. (W.D.N.Y. 1984), the court determined from the summary plan descriptions, employee handbooks, and statements made to employees in exit interviews and in plant shutdown presentations that the company intended to provide lifetime benefits. The court rejected the company's contention that the absence of language guaranteeing the benefits for life demonstrated the intent to retain the right to terminate or amend the plan. In fact, the court cited with approval the language in Yard-Man that "retiree benefits are in a sense 'status' benefits which, as such, carry with them an inference that they continue as long as the prerequisite status is maintained." Thus, both Yard-Man and Bethlehem Steel suggest that an employer may alter retiree health benefits only if he has unambiguously reserved the right to do so

in the applicable contracts and clearly communicated this fact to employees.

The concept that retiree benefits are "vested" by reason of retiree status was expanded by the district court decision in Musto v. American General Corp., (M.D. Tenn. 1985). The court treated retiree welfare benefits as "deferred compensation" which has been earned in exchange for the services provided by the previous employee. However, the court qualified its sweeping rationale in allowing unilateral modification when disaster threatened. Since American General was financially secure, the court held that such necessity did not exist.

The implications of the Musto decision have been dulled by the Sixth Circuit opinion in White Farm. Because welfare benefits are explicitly excluded from the vesting and funding standards mandated by ERISA, the circuit court held that retiree health benefits did not vest automatically at retirement but could be vested only by the contractual terms. Nevertheless, the court believed that mandatory vesting of retiree welfare benefits might be appropriate, but was an issue for the legislature, rather than the courts, to decide.

In the absence of statutory regulations which insure the security of retiree health benefits, the court had to determine whether these benefits were promised for life in the applicable contracts. The court examined all written and oral representations made to employees to determine whether White Farm in fact intended to provide health benefits to retirees for life. In defining the inferences and presumptions that should be used in interpreting the plan documents or collective bargaining agreements, the court cited Yard-Man and other cases which held that in the absence of a specific limitation on the duration of retiree health benefits, these benefits were intended to be provided for life. [See Weimer v. Kurz-Kasch, Inc. (6th Cir. 1985), Policy v. Powell Pressed Steel Company (6th Cir. 1985), UAW v. Cadillac Malleable Iron Company, Inc. (6th Cir. 1984), UAW v. Yard-Man, Inc. (6th Cir. 1983), Upholsterers' International Union of North America, AFL-CIO v. American Pad & Textile Company (6th Cir. 1967)] But at the same time, the court dissolved the mandatory injunction requiring White Farm to continue paying health and life insurance premiums for retirees. As a result, the retirees are not receiving any health benefits from the company at this time, and in light of the circuit court decision, the retirees are unlikely to pursue further legal action to restore them.

In sum, the court ruled in White Farm that an employer may terminate the benefits in question if he has unambiguously reserved the right to do so. However, the court established a strict standard in determining "unambiguous" language. Although White Farm had stated in its 1978 summary booklet issued to its employees and retirees that "the Company does reserve the right to change the plans, and, if necessary, discontinue them," the court concluded that the termination provisions and their applicability to the benefits in controversy were not in fact clear and unambiguous.

PROTECTION UNDER THE BANKRUPTCY CODE

The bankruptcy system serves two purposes: economic rehabilitation through the discharge of debt and efficient distribution of assets to creditors. Ideally, bankruptcy should treat a legal right just as it would be treated outside of bankruptcy. Of course, because bankruptcy normally follows insolvency, such rights cannot be respected in full. The Bankruptcy Code (BC), recently amended by the Bankruptcy Amendments of 1984, provides the statutory framework for the Chapter 7 liquidation or Chapter 11 reorganization of most corporate employers and it determines the allowance and the priority of claims in a case commenced under it. The BC's automatic stay provision prohibits collection efforts by creditors, avoiding piecemeal liquidation of company assets and assurance that division of assets will not be determined by a race to the courthouse.

Chapter 11 of the BC permits a corporate debtor to reorganize its business to avoid liquidation and to preserve the going concern value of the corporation through the confirmation of a plan which sets forth the treatment of claims held against the debtor. The court appoints a committee of creditors to consult, investigate, formulate, and solicit acceptances or rejections of the plan from various creditors. To be confirmed, the court must find that the plan complies with the BC. Confirmation of a plan discharges a debtor from any debt that arose prior to the date of confirmation.

Under the BC, claims against the debtor are either secured or unsecured. Holders of secured claims are entitled to substantially greater protection than the holders of unsecured claims. Within the category of unsecured claims, there are seven levels of priority claims which must be paid in full before the holders of general unsecured claims will receive any payment: (1) administrative expenses, to preserve the estate, including wages, salaries, or commissions, which arise in the ordinary course of business; (2) unsecured claims arising after the commencements of an involuntary care and before the order for relief; (3) unsecured claims for wages and salaries; (4) unsecured claims for contributions to employee benefit plans, arising from services rendered within the 180 day period prior to commencement of the case; (5) unsecured claims for grain and fish; (6) unsecured claims of individuals for up to $900 of deposits; and (7) certain unsecured tax and custom duty claims. The term "employee benefit plan" in the 4th priority is intended to include health insurance programs, life insurance plans, and all other forms of employee compensation that is not in the form of wages.

COLLECTIVELY BARGAINED BENEFITS IN BANKRUPTCY

The National Labor Relations Act (NLRA) was designed by Congress, in part, to establish and protect a uniform system for "collective bargaining," and it specifies the conduct constituting unfair labor practices. The purpose of the NLRA is to promote "the flow of commerce by removing certain recognized sources of industrial strife and unrest." The nexus between the NLRA and the

BC lies in the fact that a collective bargaining agreement (CBA) is a type of executory contract, and while it is protected by the NLRA, it is also subject to rejection under the BC.

As part of the Chapter 11 rehabilitation process, the debtor often wants to terminate contracts and to reduce employee wages and benefits. Section 365(a) of the BC permits a debtor to reject, with the bankruptcy court's approval, the executory contracts of the bankrupt business. The ability to reject burdensome or unprofitable contracts is one of the most significant privileges granted the debtor by the BC. If the debtor exercises his right to reject, the other party is limited to an unsecured claim for damages.

Prior to 1984, the BC did not expressly define CBAs as rejectable executory contracts. Courts, however, uniformly treated labor agreements as executory contracts and held that the agreements could be rejected in a bankruptcy proceeding. The courts also realized that the rejection of CBAs may be contrary to Section 8(d) of the NLRA, which prohibits the unilateral mid-term modification or termination of labor contracts. The question became whether the bankruptcy procedure allowed rejection of an executory labor contract or whether the NLRA prohibited such termination.

In 1984, the Supreme Court declared, in NLRB v. Bildisco & Bildisco, that CBAs were subject to termination by companies in reorganization under Chapter 11 of the BC and, most importantly, that the debtor does not violate the NLRA by modifying or terminating a labor agreement unilaterally prior to court-approved rejection. Congress acted quickly to overturn the decision by enacting 1984 Amendments to the BC. Those amendments contain Section 1113, which establishes the procedures and standards to be followed in rejecting a CBA. The amendment is intended to prevent debtors from rejecting those contracts before the bankruptcy court has given permission and to encourage the CB process as a means of solving a debtor's financial problems as they affect its union employees.

Section 1113 procedures are triggered after filing a petition in bankruptcy. The debtor must show the court that it has: made a proposal to the union outlining modifications in the CBA; including only those changes that are "necessary" to successful reognization may be proposed and ensuring that all interested parties are treated fairly; and based on reliable information also provided to the union representative. If good faith negotiations fail, the debtor may file an application for rejection with the bankruptcy court which may be approved if the court finds: that the procedures have been complied with; that the union rep has refused, w/o good cause, to accept the offer; and that the balance of the equities clearly favors rejection of the agreement.

Section 1113 sets a tight schedule for review of the rejection motion. With certain exceptions, a hearing must be held within 14 days of the debtor's motion. The court must rule on the motion within 30 days of the commencement of the hearing. Section 1113

also has two relief provisions for the debtor: (1) it authorizes the debtor to terminate or modify the CBA unilaterally pending a ruling if the court fails to meet the timetable for review and (2) it permits the debtor, with the court's authorization (after notice and hearing), to make "interim" changes in the agreement prior to rejection if essential to the continuation of the business or to avoid irreparable damage.

While the protection granted active employees under 1113 is clear, it is much more ambiguous with regard to retirees. Under the NLRA, the union has a combined right/duty to represent the interests of active employees w/i a CB unit. In Allied Chemical & Alkali Workers v. Pittsburgh Plate Glass Co., the Supreme Court held that this duty of representation precluded the union from attempting to bargain on behalf of the retired employees over certain changes the employer had made to health benefits. In Century Brass, a recent Sec. 1113 case, the UAW, relying on Pittsburgh Plate, argued that pensions were vested and of lifetime duration, so as not to be renegotiated, and that it could not represent retirees. The Court of Appeals for the 2d Circuit, held that no modification of retirees' pension could occur absent their consent and, that while the union could not represent them because of a conflict of interest, a representative should be appointed for them. A petition for rehearing has been filed.

CONCLUSION

The pattern of retiree health benefit cases which has emerged in recent years resembles that which developed in the pension area prior to the enactment of ERISA in 1974. The courts have revealed the inadequacy of ERISA in providing protection to health benefits that retirees desparately rely upon. Retiree health benefits remain vulnerable to unilateral termination by the employer caught in a variety of circumstances.

IV. RECENT TRENDS

A growing number of companies have altered or terminated retiree health benefits in response to the dramatic escalation of health care costs, in particular the costs for older patients. Moreover, the looming crisis in Medicare finances is likely to push additional expenses now covered by Medicare onto retiree insurance plans funded by private employers. The earlier discussion of recent court decisions illustrated that employers confront serious legal and practical difficulties if they try to reform, modify, or eliminate established health benefit programs for workers who have already retired.

TERMINATIONS RESULTING FROM BUSINESS OR PLANT CLOSINGS, STRIKES

Other benefit cessations have occurred when companies have simply ceased operations as a prelude to going out of business. As an example, New Castle Foundry closed its operation in June 1980. Until March 1979, it had operated under the name of Davis Foundry. The collective bargaining agreement with Davis expired in June 1979, and a new one was negotiated and was to expire in June 1982. When New Castle Foundry closed a special agreement was reached that, according to the union, obligated the employer to pay for life, medical, and hospital insurance for the life-time of those disabled and/or retired. The employer paid the premiums until June 1982, when the collective bargaining agreement expired. When it stopped making the payments, the union sued. The court ruled in favor of the employer based on the termination clause contained in the agreement. The Bunker Hill Company also ceased its operations and discontinued health insurance coverage for retired employees and their survivors.

The closing of a facility of an on-going business has also led to loss of retiree benefits. Yard-Man, Inc. involved a three-year pact agreed to by the employer and the union at a plant that shut down less than a year later. Retirees were notified that their life and health would terminate when the contract expired. The union sued with the ultimate decision being that retiree life insurance and health care coverages were meant to extend beyond the life of the collective bargaining agreement covering a closed plant. A similar situation with a like outcome occured with Powell Pressed Steel Company, Mount Vernon Die Casting Company (purchased by Teledyne, Inc. who closed the plant) and Kurz-Kasch, Inc. When Roblin Industries shut down a steel and wire manufacturing facility, a slightly different outcome occured; the case was disposed of in a conference settlement before being heard, resulting in continuation of coverages but only for a specified length of time. Still in litigation is the case of a Hills-McKenna plant that was sold to Rockwell International Corporation and subsequently shut down.

Termination of retiree health benefits during a strike is another category to examine. When Cadillac Malleable Iron Company terminated retiree benefits during a strike, the issue became whether the company could terminate the benefits during a strike which followed expiration of the collective bargaining agreement or whether the coverages were to be continued for the retirees' lifetime. The courts ruled that retirees indeed were eligible for continued health benefit coverage, and that labor unrest was not a proper reason for cessation.

Of less disastrous consequences, but still of a serious nature, is the recent trend of businesses modifying retiree health benefit plans. The obvious thrust of these actions is to reduce costs. Examples include Uniroyal, Bethlehem Steel and Armco Steel. To highlight one case, Bethlehem retirees sued the company when it tried to cut back what had been promised to be lifetime medical benefits. Following a year of legal proceedings, the out-of-court settlement resulted in a separate health care plan being devised

and established which includes a permanently fixed premium as well as various cost containment provisions.

BANKRUPTCY: LTV CORPORATION

In the process of reorganization, a company may find it necessary to terminate health benefits it has promised its employees upon retirement. Troubled companies which end up in bankruptcy, in particular, often encourage workers to retire early to cut labor costs by compensating these individuals with health and life insurance coverage. Because the liability for retiree health benefits has become so large, some companies may enter Chapter 11 Bankruptcy simply to rid themselves of these costs. Chapter 11 bankruptcies have increased 204 percent from 6,815 in 1981 to 20,733 in 1986. As a result of the growing number of companies filing bankruptcy, a large number of retirees have been denied health benefits they have relied upon and have earned by their years of employment. Individuals have little guarantee that health and life insurance coverage they receive at retirement will continue in the event of bankruptcy.

The most recent, and most notable, attempted elimination of retiree health benefits occured on July 17 when LTV Corporation declared bankruptcy and filed for Chapter 11 protection. LTV, a growing conglomerate in the 1960's has been experiencing difficulties since 1981, the last year it made a profit. The company was formed in 1961 when James Ling, a former electrician, merged his Ling-Temco Electronics Company with Chance Vought Aircraft, thus the current name of Ling-Temco-Vought (LTV). The company entered into the steel industry by obtaining control of Pittsburgh-based Jones & Laughlin Steel in 1968, and expanding further with the acquisition of Lykes Corporation, parent of Youngstown Sheet & Tube in 1970. In 1984, LTV further increased its involvement in steel when it acquired Republic Steel for $770 million. With the decline in steel prices and continued pressure from foreign imports, the merger proved not to be advantageous for LTV. Desperately short of cash after losing more than $1.5 billion since 1981, LTV chose bankruptcy on July 17 because it saw no prospect for a fast turnaround in the domestic steel industry's extended slump.

Chapter 11 of the Bankruptcy Laws of 1984 permits a company to remain in business while working out a plan to repay its creditors. When LTV filed for Chapter 11 bankruptcy protection, it announced termination of health benefits and life insurance for retirees effective immediately for all unpaid bills. The company claims that, under the bankruptcy code, it is required to reject obligations as pre-petition debts when they file for reorganization. The counterargument is that the benefits are part of the collective bargaining agreement and cannot be shed without approval from the Bankruptcy Court. Section 1113 of the Bankruptcy Law sets forth the procedure and circumstances under which the company can reject the collective bargaining agreement. The pivotal point is the determination of whether retiree health benefits are an integral part of the collective bargaining

agreement and therefore subject to the provisions of Section 1113. Secondly, if they are, the judge must rule on whether the benefits can properly be rejected through the outlined procedure in Section 1113.

The USWA struck LTV's mill in East Chicago, Indiana on July 25 to protest the benefits cancellation. The union's international headquarters sanctioned additional local strikes at LTV plants in Cleveland, Ohio and Hennepin, Illinois to occur at 11:00 PM on July 31 in response to the benefits cut-off.

LTV announced on July 28 that it would offer alternative coverage through Metropolitan Life and John Hancock Mutual Life to retirees who had their benefits cancelled. The alternative coverage costs $39 a month for retirees eligible for Medicare and $132 a month for those not yet eligible for Medicare. These costs were to have been kept in the reasonable range by limiting benefits relative to the LTV plan through a $500 deductible and a 20% copayment. The plan would have had no restrictions for preexisting conditions and would have been retroactive to July 17.

The need for the alternative coverage and/or continued or additional labor walkouts were averted when, on the evening of July 30, a New York Bankruptcy Judge approved LTV's request to restore the benefits. Under the court order, the benefits will be paid in full to retirees for 6 months with an expected price tag of $70 million. The court decision was prompted by two occurances, the first being the aforementioned labor unrest. Second, Senators Heinz, Metzenbaum, Glenn, and Specter introduced S 2690 to pay health benefits for retirees until ordered to cease by the Bankruptcy Court. The legislation was passed by the on the evening of July 30 and is currently referred to the House Judiciary Committee. Chairman Rodino has announced hearings for Thursday, August 7. Other legislative activity has included introduction of S.J.Res. 380 on July 28 by Senator Durenburger instucting Tax Reform conferees to dedicate Investment Tax Credit (ITC) cash payments for steel companies to the payment of retiree health benefits for any companies filing for Chapter 11 protection in 1986. LTV expects to receive approximately $150 million from ITC cash payments, more than enough to pay anticipated 1986 retiree health benefit costs of $120 million.

Other recent losses attributable to bankruptcy declaration include Wheeling-Pittsburgh Steel, Mesta Machine, an White Farm Equipment. For example, Mesta Machine Company in Pittsburgh filed for bankruptcy protection in 1983 and cancelled life and health insurance for retirees immediately. Retirees have banded together to seek alternative means of insurance.

V. ISSUES AND RECOMMENDATIONS

LACK OF VESTING

When Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA), it clearly exempted health and welfare plans from the protections provided participants in pension plans. The courts have generally found that, in the absence of ERISA protections, health benefits are not vested for life at retirement and can be terminated by employers as long as any contractual obligations are met. Most experts feel that if employers clearly communicate that benefits can be terminated, they can cancel them.

In addition to being insecure in retirement, retiree health benefits are also difficult to earn. Unlike pensions, where a partial career can earn a partial benefit, retiree health benefits are only provided to workers actually retiring from the company. Eligibility for health benefits is often limited to those retirees who are eligible for a pension. Workers who leave a company before retirement earn no partial benefits.

The issue is whether Congress ought to mandate that retirees vest (have a non-forfeitable right to) health benefits and whether vesting should occur at retirement or earlier in an individual's working career. Mandatory vesting at retirement would limit the legal right of an employer to unilaterally reduce or eliminate retiree health benefits. It would not, however, guarantee that benefits would be paid if the company declared bankruptcy or folded.

NEED FOR FUNDING AND BENEFIT GUARANTEES

Although the majority of large companies now provide retiree health benefits, practically no companies set aside any advance funding for the cost of these benefits. The costs of retiree health benefits are usually absorbed in the annual cost of the employer's health plan on a pay-as-you-go basis. The Department of Labor has estimated that employers have promised $98 billion more in future retiree health benefits than they have assets set aside for this purpose. As a result, even if health benefits are promised to retirees, there is no guarantee that the money will be there to pay them. Without separate assets set aside for this purpose, retirees have to stand in line in bankruptcy with all other unsecured creditors.

Pension benefits are treated quite differently. ERISA mandated that pension benefits be funded by the employer as they are earned by participants. Under the law, an employer must meet ERISA's minimum requirement for funding or obtain a waiver from the Internal Revenue Service to defer a required contribution.

ERISA also established a benefit guarantee program to ensure that if a company terminated a plan without sufficient assets to pay benefits, participants would receive a guaranteed benefit

payment anyway. Plans terminating with insufficient assets are trusteed by the Pension Benefit Guaranty Corporation (PBGC) and benefits are paid with funds raised by charging all insured pension plans a premium.

Funding, vesting, and benefit guarantees are related issues. Without a commitment to pay future benefits to retirees, there is no need for funding or benefit guarantees. In fact, unless benefit promises to participants are non-forfeitable, funding would provide employers with tax benefits with no assurance that employees would derive anything of value. If there are no funds set aside, however, the promise to pay benefits is a hollow one.

Practically no employers are currently funding retiree health benefits due to the lack of tax-favored funding options and the open-ended liability for future benefits that comes with funding. Prior to 1984, retiree health benefits could be funded through the use of welfare benefit funds or as part of the pension plan under section 401(h) of the Internal Revenue Code. When Congress closed the use of welfare benefit funds for retiree health benefits in the Deficit Reduction Act of 1984 (DEFRA), only a few employees had begun to use them for this purpose. Congress eliminated retiree health funding through welfare benefit funds because of a potential for tax abuse - liabilities do not exist without vesting, are difficult to estimate in any event, and amounts set aside by employers and not used for this purpose could revert to the employer. In the wake of DEFRA, employers who choose to fund can only fund retiree health as an ancillary pension benefit under section 401(h).

Employers have shown little interest in funding retiree health benefits largely due to an unwillingness to commit themselves to these benefits in the distant future. However, employer interest in funding has begun to increase with the threat that the Financial Accounting Standards Board (FASB) may require liabilities for future benefits to be included in corporate balance sheets. Currently, FASB only requires that companies disclose these liabilities in a footnote. A requirement to actually include the liabilities in net worth would increase pressure on the Congress for a suitable tax-deferred funding vehicle.

Congress has the choice of enacting permissive or mandatory funding for retiree health. One option is to permit employers to offer retiree health benefits without funding them, but to permit employers who choose to fund these benefits to make tax-deductible contributions to a non-taxable trust. Funded benefits would vest over the employees' worklives or at retirement, depending upon the nature of the funding. Although Congress could mandate vesting for non-funded benefits as well, vesting by itself would do little to guarantee benefits for retirees in companies going out of business or declaring bankruptcy. Essentially, this approach would only protect benefits provided by employers who want to use it.

Alternatively, Congress could mandate vesting and funding and establish a program of benefit guarantees. Under this approach, as with pension benefits, employers could only offer retiree health

benefits if they met minimum standards for vesting and funding. In addition, to provide benefit security while plans are funding up to meet existing liabilities, and to provide permanent protection against underfunding, Congress could establish a benefit guarantee program for retiree health similar to the single-employer pension guarantees under Title IV of ERISA.

Funding retiree health benefits is a more complex task than funding cash pension benefits. Funding a health benefit requires accurate prediction of future health care costs discounted to present value terms. Future health care cost, however, is affected not only by general inflation, but by changes in nature of health care itself and additional medical cost inflation. Adopting agreed-upon standards for actuarial valuation and funding of defined health benefits is much more difficult than adopting standards for valuing cash benefits.

Enacting a workable tax-favored funding mechanism for retiree health benefits would also open up a new category for Federal revenue loss. Unless contributions to retiree health funds were made in lieu of anticipated wage or pension increases, the cost to the Federal government could be substantial. If funding is made available for cash benefits only, however, limits could be placed on the dollar value of these cash benefits to control revenue loss.

Encouraging the use of cash benefits to purchase health coverage may also create individual tax problems for retirees. Currently, employer-paid health coverage is a tax-free benefit for retirees, while cash benefits are taxable. If retirees now receiving employer-paid health coverage were instead continued in the health plan and provided cash to pay the premiums, the additional taxes they would have to pay on the cash would reduce the value of this benefit. These tax implications should figure prominantly in the design of any funding mechanisms for retiree health benefits.

LACK OF COVERAGE

Employers voluntarily (or through collective bargaining) agree to provide health benefits after retirement to former employees. Although employer-health plans now cover over 86 percent of all workers, only one-in-six older Americans currently have health benefits in retirement through their former employer or spouse's former employer.

The lack of widespread coverage in retirement under employer-sponsored plans presents a policy dilemma conflicting with the need for additional benefit protections. Federal legislation substantially increasing the employer's liability to retirees without additional incentives to provide retirees health benefits would discourage employers who don't offer retiree benefits from adopting them, and would encourage some employers who do offer retiree benefits to terminate them or terminate the group health plan altogether.

Coverage has two components: continuation of retirees in the employer's group health plan, and paying for the cost of continuation. Both are valuable benefits to retirees. Continuation in the group health plan can be accomplished with relatively little cost or risk to the employer, as long as the premium and additional administrative costs are paid by the retiree. The opportunity to remain in the employer's group can substantially reduce a retiree's cost of health coverage.

In the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), Congress took the first step in mandating that employers offer continuation of coverage to various categories of former employees and dependents of former employees. While COBRA did not extend continuation to retirees, Congress could mandate continuation for this category of former employees in the future. Retirees would still be required to pay a premium for the coverage, but would benefit from the lower group rate and the ability to be covered for pre-existing conditions.

Additionally, Congress could encourage employers to provide, and possibly fund, employee premiums for continuation of coverage. The design of a voluntary funding vehicle for employers who want to pre-fund these premium could serve as an incentive for employers to provide the cost of continuation as a benefit to retirees.

A major barrier deterring employers from offering health benefits to retirees is the open-ended nature of the potential liabilities and uncertainty about what the employer role could become if the Federal Government continues to reduce the role of Medicare in financing health care for the elderly. Limiting funding and benefit guarantees to a defined cash benefit, as opposed to open-ended health benefits, would help to encourage employers to enter into the payment of retiree health benefits.

INSECURITY OF BENEFITS IN BANKRUPTCY

Even when employers promise and fully expect to provide retirees health benefits for life, these obligations, like all other unsecured pre-petition debts, often cannot be paid in bankruptcy. Funding of retiree health benefits would secure these claims to the extent they are funded. Benefits in excess of the amounts funded, however, would be unsecured and eventually only partly paid. Enactment of a benefit guaranty program similar to that for pensions would protect the rights of participants in bankruptcy to the extent of guaranteed benefits.

Alternatively, the Congress could secure the debt for retiree health benefits by providing an automatic lien for this debt against the employer's assets. By creating a lien for retiree health, the Congress would be placing a higher social value on the company's obligations to its retirees than on its obligations to other creditors. It can be argued that the retirees as a group are less able than other creditors to enter into the arrangement of their own free choice, and thus have not anticipated or accepted

the risk involved, and should be protected as innocent parties by the Congress.

Placing a lien on companies for retiree health benefits they promise would have a chilling effect on the willingness of employers to provide retiree health benefits. Even if companies had the opportunity to pre-fund these benefits, other creditors would be less willing to lend money to companies that offered retiree health benefits to employees.

STAFF RECOMMENDATIONS

Legislation in the near future to make retiree health benefits more secure should be accomplished without making the obligations of employers who now voluntarily provide these benefits so great that they terminate plans and reduce coverage. Simple solutions such as mandating vesting may actually reduce the protection of retirees under health plans, unless acceptable limits can be placed on the liability for employers. Long run solutions should provide full protection for all retiree health benefits. In the immediate future, the Committee recommends the following:

1) Employers should be permitted to fund cash benefits that retirees could use to purchase continuation in the employer's health plan. These funds could:
   - be incorporated into the employer's defined benefit pension plan or qualified as a separate defined benefit pension plan;
   - meet all current ERISA standards for defined benefit plans, including participation, vesting, funding, and fiduciary standards, and should be backed by existing Title IV benefit guarantees;
   - be non-taxable when paid to retirees to the extent that cash payments are actually used to pay health premiums.

2) To ensure at least basic access to coverage, Congress should mandate that employers providing health coverage to their employees provide retiring workers the opportunity to continue in the plan by paying a premium equal to the group rate plus administrative costs.

3) Participants in plans that are not pre-funded should be clearly notified if employers intend to reserve the right to modify or terminate benefits. In the event the employer plans to discontinue the payment of premiums, notification to participants should be required 6 months in advance of termination.

4) Additional study should be given to methods for providing full protection for retiree health benefits, including methods for fully funding the costs of retiree health coverage, automatic liens against companies for unfunded liabilities.

Item 2

QUESTIONS SUBMITTED BY SENATOR GRASSLEY TO WILLIS GOLDBECK

1. You noted in your statement that the trend in the past two years has shown a change from benefit expansion to benefit reduction. Do you have any quantitative data on this, on what the dimensions of it are?

(Follow Up:) What about the causes of it? Can you summarize what might be happening?

2. How much of the problem we are discussing here is attributable to failure of companies to inform employees and retirees of the possibility that their health benefit plans might be terminated or reduced?

(Follow Up:) Would better awareness on the part of employees help reduce the occurrence of personal situations like those on the first panel described, or would it make any difference?

Response to Senator Grassley's Questions:

Your question asks if there are data to substantiate the claim that the trend in employee health benefits in the past two years is from benefit expansion to benefit reduction. The answer though yes, is a qualified one, and the issues the question raises are complex.

The complexity of the issue derives in part from the difficulty in defining what is meant by benefit reduction. Many employers rightfully can argue that whereas they have reduced the level of benefit provisions, they have not done so by increasing employee costs or by providing less essential services. Such efforts as utilization review, case management and employee incentives are just a few of the many ways that employers are reducing the overall provision of health services (and the cost to their plans), while actually benefiting their employees. For example, many companies will now provide greater reimbursement to employees who have second opinions for elective surgery, covering up to 100% of the costs, while paying less for those who don't elicit a second opinion. Substantial cost savings have ensued to companies instituting such a reimbursement system. Although this may be construed as a benefit reduction, it is best characterized as a prudent management technique of no cost to those employees willing to respond to the plan incentive. In addition, an enlightened view recognizes the value to the employee of the reduced incidence of unnecessary surgery. Other efforts, such as worksite wellness or generic drug programs, are "new" benefits, whose goals ultimately are to reduce the overall cost to the health plan. Certain categories of benefits, such as dental care, have increased in frequency in overall company plans. (please see the Hewitt Associates reports, Salaried Employee Benefits Provided by Major Employers in 1985, and Salaried Employee Benefits Provided by Major U.S. Employers: A Comparison Study, 1979 Through 1984)

One definite trend in employee benefits has been the increase in mandatory cost-sharing by employees. The Hewitt surveys have found that between 1982 and the end of 1984, the percentage of company plans that included a deductible for inpatient hospital services increased from 30 percent to 63 percent. In 1984, fourteen percent of those plans had deductibles higher than $150 dollars, in '82 only 1 percent of plans charged more than this amount. The number of companies paying 100% of reasonable and customary charges for surgery have decreased from 48% in '82 to 27% in '84. During this time, the number of employer plans requiring employee contributions increased from 31 percent to 40 percent. In addition, co-payments by employees were found by the Hewitt study to have increased.

Although good data are not available on the most recent changes in corporate benefit plans, most indications are that the trend toward employee contributions has continued in '85 and '86. Plan changes, which often were initially applicable only to salaried

employees, are now becoming the object of negotiated labor agreements. For example, several of the new agreements bargained by the Communication Workers with the regional Bell companies have included increased cost sharing by employees.

These changes are often perceived as examples of the trend toward "benefit reduction." Employers, however, have argued that the increase in employee cost sharing exemplifies a realistic and reasonable attempt to share equitably between employer and employee, the galloping cost of medical care. In addition, it is argued correctly that the increased cost sharing characteristic of the last several years has been effective not only in reducing costs commensurate with the amount of increased employee contributions, but also with those associated with unnecessary utilization. Much of the enthusiasm among employers for benefit changes that require employee contributions stems from a 1981 Rand report which showed that employee cost sharing reduces the overall demand for health services. In fact, Xerox Corporation, in explaining its benefit plan changes to its employees, cited the study as the primary rationale for increased cost sharing.

Another complicating point to the "qualified yes" response to the Senator's question is that employers, in addition to requiring increased cost sharing, are also reducing the maximum economic risks for employees. This is being accomplished through the provision of "stop loss" coverage whereby the employer pays all incurred expenses over a certain maximum out-of-pocket amount paid by the employee. The number of companies providing a stop loss feature in their plans increased from 59 percent in 1979 to 87 percent in 1984 according to the Hewitt study. A good example are the recent changes to the benefit plans at the National Cash Register Company (NCR). The company's old plan did not charge any deductibles to employees. The new plan has added deductibles but has also decreased the stop-loss or out-of-pocket limit from $1,500 to $1,000 for individuals and from $5,000 to $2,500 for families.

In addition, lifetime maximums, the amount that employers will contribute to the lifetime medical care costs of employees and their families, for the most part have increased over the past few years. In 1982, 60% of plans with lifetime maximums (87% of all plans) had levels below $250,000 dollars. In 1984, only 12% of these plans had maximums under $250,000. To use the NCR Corporation as an example once again, the company in redesigning their plan increased lifetime maximums from $250,000 dollars to $1,000,000 dollars. This substitution of catastrophic protection for a comprehensive payment plan is another example of the difficulty in unambiguosly declaring that benefit coverage is being reduced.

The second part of your question asks why benefit consolidation is now a trend. The simplest explanation for the multifaceted employer attempt to manage health care costs is the tremendous growth in the cost of medical care. As you are aware, the cost of medical services has repeatedly outstripped the increase in the cost of living; in 1985 this differential was more than two-

fold, with the inflation rate at 3.9 percent and the total cost of health services increasing 8.9 percent. Employers are realizing that their future financial health may be dependent on their ability to control benefit costs, the least controllable of which, up until recently, having been employee and retiree health. Even given the cost management measures mentioned above, average medical claim costs for employees of companies surveyed in the Hewitt study increased over 25 percent between 1982 and 1984. Similar findings were shown in a study conducted by the Health Research Institute, where average per employee cost for health care coverage increased from $1,579 dollars to $1,770 dollars between 1983 and 1984. The overall expenditure for employers surveyed by HRI represented 39.2 percent of net earnings in 1984, 10.0 percent of net payroll. It's no wonder that companies are continuing to make plan alterations up to this very minute.

Aother reason fueling the cost manangement strategies of employers is the desire to remain competitive and attentive to the bottom line. Health care is not alone in the areas that are being scrutinized by employers for potential cost savings. Early retirement incentives, a major concern to the Senate committee, are frequently used as a cost management strategy.

(2.) A further question is to what extent the problems that we have discussed in the hearing are attributable to the failure of companies to inform employees and retirees of the possibility that health benefits may be terminated or reduced.

The health benefit problems discussed in this hearing have aspects that are unique to financially troubled employers and those that are relevant to all employers, regardless of financial health. It is important to reiterate our earlier testimony that the problem of bankruptcy is a different issue than the corporate attempt to manage health care expenditures, although the failure of the latter may invite the former. An LTV which because of financial insolvency attempts to terminate its health coverage to retirees is different from a financially sound company concerned about future costs.

Regardless, however, a better informed employee or retiree is in a better position to manage health care needs and costs. Although out-of-pocket costs may increase, a thorough and clear explanation of the possibilities of future benefit changes coupled with counseling and other services for those in need, may reduce the concern and surprise often associated with benefit plan changes. In fact, most benefit plan changes that currently are being instituted by major employers do incorporate a healthy dose of employee communications. A recent Harris survey done for the Equitable Corp. has shown that employee satisfaction with benefit plan changes is associated with employee perception of the company representatives as effective communicators of those changes (e.g.: According to the Harris survey, 91% of employees who characterized their company's communication efforts as excellent viewed their benefit plan changes as either acceptable or "somewhat" acceptible. Only 62% of companies rated as poor communicators were deemed to have made acceptable or somewhat acceptable changes).

Many companies now are informing their employees and retirees of possible future plan changes. To expect employers, however, to have had the foresight to predict the continuing steep increase in the cost of medical care, and to both have planned for and informed employees and retirees of potential changes, is not realistic. Five to ten years ago, employers and employees alike saw no difficulty with the unfettered continuation of then current benefit plans. The vast majority of plan changes had been improvements, the retiree health care liability issue was not recognized as such, and the possibility of cost pressures requiring a reduction in coverage was not forseen.

Part of the problem and its development is psychological. The exit interview is the traditional time when employees are informed of their retirement benefits. But no benefit manager wanted to be a Cassandra to employees of long stead; so conversations, designed to be upbeat, rarely took the form of cautioning the future retiree of possible future plan changes.

Even as recently as last December '85, 37 percent of our own members' benefit managers attending our annual conference

reported that they had not "personally read the clause of [their company's] retiree health benefit pamphlet pertaining to the alteration, or termination, of retiree health benefits." Nearly half (49 percent) of the managers whose departments participate in pre-retirement planning were not "confident that the retiree health benefit verbal presentations [in pre-retirement planning sessions] comply with written benefit statements." No doubt, few if any managers will make this claim a year or two from now.

Better awareness on the part of employees and retirees should help reduce some of the problems associated with benefit plan changes. Employers are increasingly becoming aware of their responsibility to increase that awareness by informing employees and retirees of the specifics of their coverage. Many companies, as a means to improve the health care choices of their current and former workers have also incorporated information on the most effective use of benefits, on health promotion and disease prevention, and have conducted seminars for employees and retirees on such subjects as "how to get the most out of a doctor's visit." There has been a tremendous increase in written communication to retirees on the topic of benefit design and cost management strategies. Some companies include health related information for retirees as regular features of employee publications.

In answering the follow-up question on whether a better awareness by employees would reduce the incidences of underinsurance, it is important to keep in mind that the LTV situation is the exception and not the rule. Most benefit plan changes are relatively minor plan alterations, not outright plan eliminations. Often it is difficult to predict the necessity of such drastic a measure as bankruptcy. One would suppose, however, regardless of the situation, that the more advance notice given, the greater the flexibility for the effected plan participant.